CREDITS COLLECTIONS AND FINANCE

CREDITS COLLECTIONS & FINANCE

ORGANIZING THE WORK
CORRECT POLICIES AND METHODS
FIVE CREDIT AND COLLECTION SYSTEMS

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I

ESSENTIALS IN CREDIT MANAGEMENT

By Edward M. Skinner
General Manager, Wilson Brothers

CREDIT is the name given to that business operation by which delivery of money, merchandise or other consideration is made on the promise of future payment. Credit is based on confidence; confidence in a man's resources and ability to pay, in his character and integrity; confidence in the stability of the locality in which he conducts his business, in the country itself; confidence in the strength of its government and the soundness of its finances. Credit-making is an estimate or opinion of future commercial conditions and of the ability and intention of business men to carry out their business contracts.

The man who pays cash uses the profits made from past business conditions; the man who buys on credit anticipates the profits of the future; hence the man who sells on credit must foresee the business conditions which are to bring these profits.

Credit-making can no longer be done on the old mathematical basis, nor with the old sweat-box methods. The scope of credit operations has so widened, credit-giving and credit-taking have become so common, that no man is so weak that he must stand brutal inquisitorial questionings into his most private affairs, no house so strong that it can afford to have an openly

cold-blooded and harsh man in its credit department, who will antagonize customers and repulse trade. The object of the credit man is in the main that of the whole selling end of a business: to sell goods at a profit.

The credit man comes into more intimate contact with the customers of a house than any other man, his relations are most delicate, he touches a man where he is most sensitive—on the question of his character and his ability. He must be pre-eminently a man who can handle people, who can reach their real selves. Anyone can get information of a certain kind by asking direct questions in a direct way and putting them down in a cold, unfeeling manner, with an "I-know-you're-dishonest-anyway" attitude—working the customer up to such a murderous frame of mind that the least he can do is to refuse to buy if he does get credit. But the man who can talk to a customer pleasantly and interestedly about his affairs and circumstances, getting a fact here and an admission there, until he has all the information he wants, without a direct question, will secure more complete and reliable facts than those obtained by a brutal, straightforward examination, and will add a friend and perhaps a customer to the house. Even if credit cannot be extended, the customer should be so handled that he will leave the office in a pleasant frame of mind. This is all a mere question of attitude and tact. It is due, not to increasing competition between houses, but to the development of greater kindliness, smoothness and tact in the outward show, at least, of business relations.

This more human attitude on the part of the credit man is of even greater importance when it is a question of handling a customer who is in the debt of the house and has got into difficulties. Many an account can be saved by tactful, though always firm, treatment; more

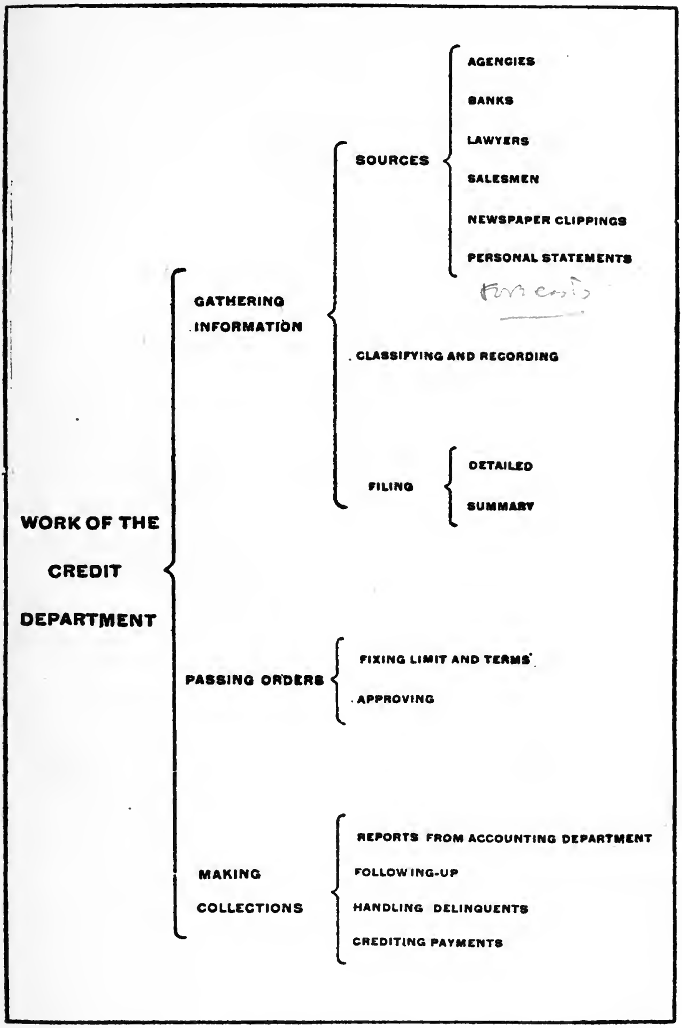


CHART I: Outline of the work of the credit department. All functions are classified under three general heads and subdivided according to the details performed

than this, many a business man or house can be saved to its creditor and to itself by a policy of advice and co-operation—real and substantial—instead of a policy of suspicion and attack.

NET *profit is the final test of the credit man's worth to his house—the value of orders rejected demands attention as well as losses from bad debts.*

The attitude which a credit man should assume is really a result of the object which he sets before him. His purpose is to sell all the goods he can, at the least possible loss, with the least possible expense, and with the least percentage of orders declined. It is easy for the credit man to show at the end of the year a loss of only one-tenth of one per cent—if he makes his credits that way. When the head of a concern receives his credit man's report, he should also ask for a statement of the number and value of orders declined. It is a very easy task to turn down orders; it is simple to keep the percentage of loss down if no chances are taken. The question for consideration is not only how little money did the credit man lose through bad debts, but also how much did he lose in orders rejected; how many prospective customers did he kill for all future sales; how many present customers did he offend or lose; how much expense put into securing orders did he nullify?

Of course, if a credit man's judgment tells him that it is unsafe to extend credit, he should refuse to grant it. But it is a far cry from refusing credit to losing an order or a customer. If it is not advisable to grant credit, the credit man should try to fill the order on some other basis. He may be able to ship the goods under some guarantee of payment; perhaps he can get the buyer to pay cash in part at least; by working in

conjunction with the salesman through whom the order has come, some satisfactory arrangement can often be made. If the credit man explains to the customer fully and in a tactful manner why he must refuse credit, expresses a desire to keep the account, and asks him whether he cannot suggest some other basis on which the goods can be shipped him, he may even receive the cooperation of the customer in making mutually satisfactory arrangements. Thus, keeping in touch with the customer, the credit man, by advising and helping in his growth, may gradually bring his account to a point where it can be put on a credit basis.

Even though a credit man does not see his way clear to opening a credit account with an applicant, the full reasons can be put to him in such a light, his own conditions can be so analyzed to him, the attitude of the house can be so laid before him, that he will go away knowing the credit man is right—and he will come back again. Instead of saying, when credit is refused him, "I'll be hanged before I ever trade with that house," he will say to himself, "I'll show that house that I am worthy of credit from them." To make such an impression requires tact in handling men, and the greatest compliment which can be paid a credit man is to have a man to whom credit has been denied come back later.

The exact balance to be kept between sales and safety is, in a large degree, a matter of house policy. It depends on the kind of business in which the firm is engaged, the class of its customers and the margin of its profits. Some houses cannot afford to run a risk; others figure it will pay them to take chances, not in an irresponsible manner, but with eyes open, and after careful consideration. It is comparatively easy to judge whether a man is really entitled to credit; to decide when to

take a chance requires experience and careful consideration.

Losses come in taking chances—so does volume of sales. That credit man excels who, taking what looks like a long chance, by such mental means and systematic methods as he possesses shortens the chance and brings it to the point of safety.

WHAT *guides the credit man in sizing up the desirability of a credit risk—factors that underlie his determination to grant or refuse accommodation.*

The basis for credit, the information in accordance with which the credit man forms his judgment, differs according to different factors. The location of a business house, the kind of goods it carries, the general character of its trade, the particular form of credit it ordinarily extends—all these modify the kind of information wanted, so that it would be futile to attempt to set down even in general the facts used in making credit judgments. Credit men themselves vary as to the particular facts they desire and find useful. Each puts emphasis on different points and facts as his experience dictates; one lays stress on character, another on ability, a third on past experience; this one considers especially the amount of capital, that one the volume of sales.

No better statement of the essential information needed to judge of the advisability of extending credit could be made than this, quoted from Mr. Horace C. Bennett: "The bases for commercial credit are ability, integrity (absolutely essential), and property (not necessarily essential), and the truth regarding these is what the trade wants.

"Ability is measured by age, health, business experience, education, income by personal effort. The evidence

of integrity is business and social honor, personal deportment, character of associates and reputation. We mean by property that which can be taken under an execution and, whether personally acquired or inherited, qualified by income and net wealth.''

While tangible assets are the chief basis for the extension of credits, yet it can be stated absolutely—and it is an agreeable evidence of the large part which the human element, man himself, plays in the more or less sordid operations of business—that the rock bottom foundation upon which the whole system of credit is based is character. Those characteristics of the man himself most significant to the credit man are rightfully identical with the most essential elements for success in any man: honesty, good habits, ability, industry, economy and care in the conduct of business. Of these rightful assets none can be levied upon by law, but just as a man cannot attain success without them, so a credit man cannot give credit to a merchant lacking them. In fact, if a credit man could be absolutely sure of an applicant's honesty, all other considerations might safely be eliminated. Not that honest men never fail, for they often lack ability and other essentials, but between the man with large resources and doubtful honesty, and the honest but financially weak man, the latter is entitled to credit, and to the former confidence should be denied.

A very significant fact, very often if not generally overlooked by a credit man in judging of a customer's title to confidence, is the volume of his sales, the amount of his expenses, and the relation between the two. It is not the amount of capital which a man has in his business, so much as the frequency with which he turns his capital over, that affords an insight into his real ability and the actual condition of his business, that shows up the true

color of his affairs and indicates the healthiness of his trade. The amount of his expenses is a true index of his business management. These two figures give the closest line on a merchant's situation. No financial report is, therefore, complete without a statement of sales and expenses.

SOURCES *of information open to the credit man for determining accurately the character, record and business responsibility of prospective buyers.*

A credit man should get all information possible regarding a customer. The first source of information, as being the easiest and quickest of access, is the rate books of the large commercial agencies, where the capital and credit rating of most merchants can be found. The next most common source of information is special reports from these agencies, which give detailed statements of the character, resources and situation of a business man. These reports are of value, for they give certain definite data and specific facts, and sometimes include a sworn and signed statement from the man investigated. But they are rarely fresh, they are revised confessedly only twice a year, and then undergo a process of rehashing rather than revising.

Local attorneys and banks can be put to very good use as commercial reporters, and are a valuable instrument to the credit man if used properly. But the practice of obtaining information from them gratuitously is a mistake. The laborer is worthy of his hire. Better returns are bound to come if the labor is paid, for even though local attorneys are in the habit of rendering such service gratis in the hope and expectation of receiving collection work from the houses they serve, they will naturally put more care and work upon a report for

which they are receiving direct and adequate payment.

Attorneys can give the latest information and the most intimate facts, for they are familiar with local conditions, they are on the spot and get their information first hand, and they are often in personal touch with the subject of the inquiry.

The value of the information to be obtained from banks depends much on the way they are approached. A clever correspondent, who presents his case as a business proposition and is candid in regard to what he wants, at the same time offering compensation, can secure very good service. Bankers are the highest grade merchants in the country; high grade reports can justly be expected from them; and usually, when they do give information, it can be relied upon.

The "credit clearing house" is one of the best instruments in the determination of credits in those lines of business represented by it. It does not duplicate the agency and other reports, but is supplementary to them. It reports only figures and facts, and really gives to a membership house access to the ledger account of the customer under investigation with every member having his trade.

ESTABLISHING *cordial relations with the selling force insures valuable cooperation in securing first-hand credit information on prospective buyers.*

Salesmen afford a valuable source of information, if the credit man will take the trouble to educate them to the observation and collection of the kind of information he desires. The good salesman will not necessarily be a good credit man, especially in the same transaction. The two activities are along different lines, and, especially when applied to the same transaction, pull in opposite

directions. But salesmen can be made valuable adjuncts to the credit department if the credit man has the tact to arouse a cooperative interest among them. To do this he must convince them that he is trying as hard as they to ship goods. He must show that he is willing to be educated along their lines, that he will do his part. Then they will reciprocate.

Once credit has been granted and a new account opened, the work of the credit man has only begun. He must not only watch each account, keep track of the amount due and over-due, the promptness in paying, the size of the orders—all of which he can learn from constant study of his ledger pages—but he must also watch each customer and his general condition, which is subject to constant and often rapid change. This he must learn from special reports, from salesmen, and from personal interviews.

This part of a credit man's work is responsible for the fact that he is generally the head office man, in charge of the bookkeeping department and the collections. From the bookkeeping and collection records only can the credit man know how much each customer owes, how much he buys, and how much he pays. It is necessary, therefore, not only that he have constant access to the books and records, but also that he have control of the methods in which they are kept, in order that they may fit into his general system.

He must also keep in touch with the sales department of the home office, for he should know what profit the various kinds of goods bear. A house can afford to take a longer chance on an order carrying a large profit than on one in which the margin of profit is very small, a default in the payment of which would mean almost a total dead loss.

The fact that the credit man must know about payments of bills in order to pass on orders, and that he alone has the intricate knowledge of customers which will indicate how to handle accounts for collection, naturally places the collection department under his control.

COLLECTIONS *require constant vigilance; only by promptness and persistence can a credit man accomplish his object—to educate customers to pay promptly.*

A credit man, to be successful, must be a good collection manager, a good collector. He must know that prompt collection of accounts is more than half the game in keeping percentage of losses down, and he must know how to educate his customers into prompt payers of their own volition. Customers who are perfectly good are often as slow in remitting as the more doubtful. The collection department should be strict with all alike; it should be after a debtor the minute a bill is due, no matter how good he is, and stick to him until the indebtedness is paid. A house which is a prompt collector and shows its customers thereby that their accounts are watched will command more respect than the careless house, and will invariably be paid first.

This does not mean that annoying or offensive methods need be resorted to the moment a bill is overdue. A statement before the account is due, marked with some excusatory phrase, as "For Correction," may be followed by a second statement as a reminder. After a reasonable length of time a sight draft may be made on the debtor. This, however, is no such infallible method now as it once was, when dishonor of a sight draft was a confession of insolvency. A sight draft has lost all its terror, and a merchant thinks no more of refusing to

meet it than he does of putting off the payment of an ordinary bill. The change has come about gradually and is the fault of the creditor class; in this, as in many other phases of collections, they have been and still are too lenient.

If a draft is returned dishonored, no one course of procedure can be laid down as the correct one to use in all cases, nor would all agree on the handling of a single given case. Credit clearing drafts are very effective, because if such a draft is dishonored the merchant knows that this fact is going to be communicated to all the members of the credit clearing association, upon whom he must depend for his supplies, and he is only too well aware of how seriously this will impair his credit. A collection agency draft is similarly efficacious. It is often well, in working on stubborn collections, to call the debtor's attention to the fact that he is hurting his credit, for there he is touched in a vital and sensitive spot.

Great conservatism is necessary in granting extensions. The efficient credit man will demand good and substantial reasons to account for delay in payments before extensions are granted, and will require a thorough knowledge of the debtor's condition. If more time is given, the creditor should seek to keep in close touch with the debtor and his affairs.

CUSTOMERS *should understand the credit department's willingness to help them; but cooperation is possible only on the condition of entire frankness.*

Sharpness and quick action are necessary when a debtor fails to pay his account and to give any satisfactory reason for his delay in paying, after repeated letters have admonished him. If the debtor understood

the real relation of the credit man to him, under these circumstances he would give a frank account of his condition, for the credit man is generally as worried over the account as the debtor himself, and as anxious to settle it. A credit man will seldom "turn down" a man who tells the truth, and will always do his best to arrange a satisfactory settlement. If such a customer appreciated the liberal feeling of the credit department toward him, if he would simply write to the credit man when he is unable to pay his account, and would make some definite arrangement for future payment, he would be surprised to find how easy it would be made for him. The credit man always wants to help the honest debtor if he can; if the debtor will not let him, he is helpless. If he makes an offer and the debtor pays no attention to it, the credit man is at the end of his string. A customer ought never to feel that, because his bills are past due and he is unable to pay them, he will fail to meet consideration at the hands of the credit man. The worse the condition he is in, the more desirous the credit man is to help him, for he cannot get his own money without helping the debtor. This may be a selfish motive, but for that very reason it is a powerful one.

In all his efforts at collection the credit man should never give offense; let him throw the tuft of grass first, just to call the debtor's attention to what may come. If this does not work, the credit man may give him the rock—but only as a last resort, for stringent methods, the collection of an account by legal means, will surely mean the loss of the customer in question. This is inevitable for three reasons: The credit man will always suspect, and justly, such a customer, for nowadays a man must treat his account pretty badly to have it put into an attorney's hands, and so he will hesitate to ex-

tend him credit again. Second, this will be a good account to drop anyway, for a man who has been sued by a creditor usually treasures it up against him and will take a joy in making trouble for him, if ever opportunity offers. Third, the customer will very rarely come back to trade with a house which has sued him.

Never to compromise an account seems to me a poor policy for any house to adopt. The usual, fairest and most satisfactory method in the case of an insolvent debtor is for the smaller creditors to accept any percentage or other settlement thought fair and just by the larger creditors. The latter, having most at stake, will always investigate thoroughly and can be depended upon to make the best possible terms. It is fairest for all houses to be thus guided by the desires of the larger creditors, for it is a reciprocal arrangement.

THE *organization and management of a credit department is not unlike the building and superintending of a manufacturing plant; each requires architect, workmen, plans, material, and tools, all selected with an intelligent conception of the ultimate purpose.*

It is the little details that make or mar the effectiveness of any structure or organization just as it is the little things of everyday life that make success or failure; nor does the likeness end there, for as life requires a sterling character, so the structure must have a firm foundation, the organization a master mind.

—Dorchester Mapes

II

THE MAN FOR THE CREDIT DESK

By F. F. Peabody
President, Cluett, Peabody & Company

AS used in most houses the title of credit man includes far wider duties than the term itself defines. The credit man is usually the responsible head of the entire office work, with general oversight over the whole bookkeeping and record department, and is in immediate control of the collections, as well as of the credit department itself. He is often cashier, too, the man who is in charge of the moneys of his house and who watches the bank balance, the bills payable and the accounts receivable.

This multiplicity of duties is due to two causes. The credit man is pre-eminently the student of the business concern. In his particular work it is his duty to reach certain conclusions from careful investigation of the characters and conditions of men, through personal touch with them, and through study of documentary reports and historical accounts. He is the one important factor in the management of a business whose work is all on the inside. Therefore, the general management of all the inside work, the office work, is assigned to him, as being the one who can most conveniently oversee it, and who is the nearest to it, both territorially and functionally.

More important than this is the second cause, which

is based upon the fact that the credit man is in closest touch at all times with the bookkeeping department. Moreover, he has as a rule come up through this department, and he must control its methods in order to carry out the policies and system of the credit department.

The test of a credit man's success as measured by his employer are four: the average annual losses, the accounts receivable measured by the average number of days' sales contained in them, the average percentage of discounts, based upon receipts, and the general office expenses, if he has the management of the office in charge. The first is a test of his ability purely as a credit man; the second and third his worth as a collector; the fourth his capacity in executive work.

GENERAL *and specific knowledge required for carrying on the work of the credit department—the three essential characteristics of a credit man.*

For his purely credit functions, the credit man needs three distinct characteristics. The first is a wide and general knowledge of business methods and business conditions. When deciding whether to open a new credit account, the credit man must know the general business conditions of the territory in which the applicant is located, in order that he may judge whether the latter's sales and collections will enable him to pay his account when it is due. For instance, if a crop failure seems imminent in North Dakota, he must draw in his credits in that region and must handle his account accordingly; on the other hand, if a well-founded and legitimate boom appears to be starting in Oklahoma, he should attempt to extend his firm's business there, and should be rather free, perhaps, in granting credit. He must know the general financial condition of the country, in order to

judge whether the prospects on which the debtor depends for paying his account will materialize, and whether his own firm can stand a further extension of its credit accounts in view of a coming financial or industrial depression.

Every business man must, of course, have a general knowledge of business methods. But the credit man must be familiar with the details of all the lines of business in which his debtors are engaged, in order to determine whether the capital, sales, expenses, and past experience of an applicant for credit give promise of his ultimate success. He must know also the elements of commercial law, the statutes of exemptions, the financial responsibility of corporation officers and of the members of a partnership, the legal age of open accounts, and similar generalities. He cannot have a detailed knowledge of these facts, but if they are a part of his general information, his credit making will be influenced and strengthened thereby.

The second necessary characteristic of the credit man is a keen insight and an analytical mind. The work of a credit man requires a succession of decisions, each one of importance, but necessarily made hastily. These judgments are not arbitrary, but are based on a study of certain groups of facts, usually of four kinds: first, the general knowledge of the credit man himself; second, impressions gained by him from personal touch and acquaintance with the customer; third, specific facts concerning the character, ability and resources of the applicant, gained in various ways, and fourth, if he is an old customer, his record with the house itself.

It takes keen insight to fix at once upon the vital and decisive factors in this great mass of material, and sharp analytical power to sift the kernels from the chaff

and to correlate the important facts. The superficial credit man is liable merely to look at a debtor's quick assets, at his total outstanding debts, without going deeper, and especially without considering his character and qualifications for success and his surroundings. The honesty, good habits and industry of a debtor, the commercial condition of the locality in which he trades, and the esteem in which he is held there, are just as much a part of his capital as the cash he has invested in the business or the amount of his unencumbered property, and are even a bigger element in his chances for success. These items are harder to discover and determine than capital and debts, but the good credit man will lay much stress upon them. In a long report, on a merchant perhaps a thousand miles away, it needs the most astute reading between the lines and the cleverest putting together of two and two to arrive at the true condition of this man's affairs. The problem is up to the credit man.

SYMPATHY *and tact guide the efficient credit man; only by means of these qualities can he get the information from customers he requires and preserve their good will.*

The credit man's third requirement is tact, and tact in the broadest possible sense. Tact means sympathy with other people, ability to put one's self in their place and understand their condition. It implies an openness to receive aid and advice, a willingness to learn new facts and change old methods. It carries with it the idea of caution and carefulness. No tactful man is impetuous; he weighs and considers all pertinent facts before he comes to a decision. Yet the very word tact implies ability to decide quickly, an intuition, almost, of the right course to take. The man of tact must have a good memory, otherwise he will make errors and blun-

ders; he must remember people's weaknesses and their sensitive spots, in order to avoid them; he must remember their interests and hobbies, in order to fraternize with them; he must remember their strength and their pride, in order to appeal to their vanity.

A tactful, sympathetic credit man will learn all he wishes from the customer who is being interviewed so adroitly that he will go away without any loss of self-respect or any feeling of resentment, yet leaving to the credit man the information he desires. The credit man has often to ask and do many things which are unpleasant and embarrassing both to himself and to the debtor. If he can do these things in such a way as to keep the customer's good will and even make himself the latter's confidant and adviser, so that the customer will voluntarily keep him informed of his condition—that is tact.

The ability to handle men is in part inborn. Some men are able to influence, to impress themselves upon their fellow men without effort, while others appear always isolated, at angles with those around them. But a very good imitation of this ability can be acquired, and nothing should be so impressed upon a credit man as the necessity of developing an attractive personality, of forcing people to like him. This ability, however, must be based upon real sincerity, and real sympathy. Mere surface smoothness, mere exuberant good fellowship, will not accomplish the object. There must be an understanding and a continuous study of human nature, a charity for human weakness, a fellow feeling of human interests. Above all the credit man should never take the attitude that mankind in general is dishonest. This standpoint will more quickly kill his efforts and ruin his prospects than even the opposite extreme. It will hurt him with his trade; it will hurt him with his house; it

will work against his success at every turn.

In his relations with the other departments of his house the credit man can make or mar his record. It is especially essential that he be willing and eager to receive information and advice from those who have an opportunity to learn and see things pertaining to his work from a different viewpoint. His relations with the salesmen of the house are particularly important and delicate. The amount of harm which a credit man with too exaggerated an idea of the importance of his office and its immense height over the realm of the salesman can do is incalculable.

Caution and carefulness in the performance of his duties have been dinned into the ears of the credit man so much that there has been danger of his going to the opposite extreme. But when it is considered that more losses result from carelessness than from any other one cause, the emphasis can hardly be made too strong.

ESPECIALLY *when a series of prompt payments have put the credit man off his guard, carelessness creeps in—the price of safety is constant watchfulness.*

The place and time for caution are especially worthy of attention. In granting credit to a new customer, special care is observed. The new name is probably wholly unknown to the credit man. He inevitably feels the need of full information, and as such information is comparatively easy to secure, he obtains it at once. He looks up the customer in the rating books; he obtains the mercantile reports on him and private statements from him. If he concludes that it is not safe to extend the credit asked he does not have that feeling of breaking a business connection and losing a customer which he has when he refuses credit to an old customer. There is

only one consideration especially liable to undermine a credit man's caution in making initial credits—the fear that if he refuses an account, a competitor will accept and profit by it. This phase of the matter should never be allowed to weigh with the credit man, for no course of reasoning could be more fallacious. Not only is he a very poor credit man who needs this consideration in helping him form his judgment, but it is also most illogical; if he believes the account unsafe in itself, and if he has the facts to back his opinion which he ought to have, he should be willing to let it go to a competitor —to the latter's undoing—for he will thus gain more than he loses.

It is, however, especially when an account has run on for a long time, when a constant succession of orders promptly paid has lulled the alertness of the credit man, that carelessness gets in its work. The credit man, overwhelmed with work, pressed for time, will allow an order to slip through here and there regarding which he is not absolutely sure, except that he knows the customer has been with the house a long time, and has a vague idea that he is good and pays promptly. It is on such accounts that he is most frequently caught. The credit man must be persistent and painstaking in his methods. By some means or system he should keep in touch with the trend of all of his accounts, both those of his good customers and those of the doubtful ones; lapses in the one should be caught and taken up as in the other.

In testing the credit man's ability and success by the average amount of his accounts receivable, the business man is really testing his ability as a collector. In the judgment of many, a clever collector is more important in most offices than a brilliant credit man. By ability to collect is not meant the power to extract money from

a refractory and unwilling debtor, but rather the ability to impress and train the debtor, willing or stubborn, in such a way that he will unconsciously get into the habit of paying promptly.

The prompt collecting of accounts has a triple compensation. It keeps outstanding accounts down, and thus requires less capital to run the business. The added value of a credit man who, by keeping his accounts receivable low, enables his employer to run his business with less working capital than his competitor, frequently amounts to more than his yearly salary. In the second place, the strict collector is the best salesman. It is an admitted fact that a customer who has a past-due account with a house will place his current order with another house; the loss is apparent. Finally, credit men agree that the great majority of losses occur among overdue accounts; a man who owes nothing cannot fail, and a man who pays every thirty days is most unlikely to become insolvent, and the merchant who is held strictly to his payments will not be likely to over-buy, in fact, he cannot.

In discussing the characteristics necessary for administering the affairs of the general office, one point needs particular emphasis. The credit man has often been accused, whether justly or unjustly, of preferring old ways and opposing new ideas and methods because of the change involved and the trouble and expense incurred in adopting them. Many of the older school of credit men are moving along in the same old way, not realizing that the doubling of the volume of their firm's business more than doubles the details of their department. This type of credit man refuses to install a modern system for taking these details off his shoulders, for dividing his work, fearing, perhaps, that the work which he has been doing

himself, if transferred to someone else, will not be done well. In thus giving his time to the performance of petty details, or even to the accomplishment of an overplus of important work, he comes to be looked upon as the busiest man in the house, an expression which is very often heard.

For a man in the position of credit manager to be over-busy must surely be considered a mistake and an injury to the best interests of the house. A credit man who performs a great deal of detail and cumbersome work, occupying all his attention and absorbing all his efforts, who allows a mass of unfinished work to accumulate, thus necessarily slighting all his work, is practicing false economy. A clerk and a well-regulated system, which would take merely the routine, not the responsibility, off his shoulders, could save him much nervous energy and irritation and leave his time and mind open for more valuable work.

The credit man must be modern in his methods. He must see that his credit department system and his general office system handle details quickly and accurately, and that this system sifts out of the details the vital facts which he should know and presents them to him quickly and in concise, comprehensive form, leaving him time for thought on problems which will always be present for his solution.

WITHOUT *organization and system, business would still be done on the small scale of olden days and the business man would still be an insignificant trader or small individual manufacturer instead of the great captain of industry of today.*

—Walter H. Cottingham
President, Sherwin-Williams Company

III

COMMERCIAL AGENCY RATINGS AND METHODS

By T. J. Zimmerman

THAT point at which the commercial agency enters into credit operations is between the receipt of the order and the shipment of the goods. Credit rests upon the seller's confidence in the buyer's ability to pay; confidence results from favorable knowledge of a man's character, ability and circumstances. In order to decide whether his house wishes to extend credit to an applicant, to determine the amount of credit which it is advisable to extend, and to decide upon the specific terms on which this credit is to be granted, the credit man must have certain general and specific information. Such information the commercial agency has made it its function to furnish.

The commercial agency is strictly a credit instrument —a product of the credit regime. Were all trade and business done on a cash basis, there would be no need or place for it. It has grown and developed in the last sixty years as the result of a definite need and an expressed demand on the part of the business world. While the result of the credit system, however, it has in its turn been instrumental in the vast extension of credit transactions and the resultant increase of business operations in the last half century.

The commercial agency had its origin in the panic of

1837. The immense losses incurred during this period of wildcat money and mushroom banks by merchants all over the East, especially in New York, which at that time was the mercantile center of the country's wholesale business, made it absolutely incumbent on them to devise some means by which they could determine what merchants were safe credit customers. Although at the time selling on credit was not so widely practiced or plentifully supplied with determining and safeguarding facilities as now, the time of the individual credits granted was much longer. It was nothing unusual to give a year's time for the payment of an invoice of goods, and six months was the usual allowance.

CAUSES *which determined the origin and growth of modern commercial agencies—how a response to a felt need brought about their establishment.*

Before this, the practice had been to keep representatives on the road whose duty it was to visit those of its customers who were in any way accessible every six or twelve months, make a more or less careful examination of their financial circumstances, and report their information and conclusions to the house. Personal interviews with customers were believed in and depended upon to a large extent in the determination of their reliability. For at that time the retail merchant, if he was within the confines of civilization, paid his regular annual or semi-annual visit to New York, Philadelphia, or whatever city was the mercantile center of his district, and did his buying in person. Thus the head of the wholesale concern was personally acquainted, and probably even a friend—for they mingled social with business relations in these visits—of many of his customers, and acquired a close familiarity with their cir-

cumstances and even established a personal bond between them and himself.

The weakness of these methods lay in the fact that just those of a firm's customers concerning whom it most needed information, and who required the closest watching, were not reached at all. This was before the days of railroads and telegraphs. New York houses were shipping goods into the wilderness of Ohio and Tennessee, even away across the unknown continent to the coast. Nothing could be learned regarding the status of these customers, the goods themselves were in transit three or six months before reaching the consignee, and a year might elapse before the firm even knew of their safe arrival. But these two methods were not even satisfactory as applied to those customers reached by them. The firm's reporters were far away, they could make only a cursory examination, and only at long intervals and at great expense, while the impressions derived from personal contact with customers were not infallible.

In response to needs of such conditions, made acute by the heavy losses of the panic of '37, came the commercial agency. It was not then what it is now. Its reports were meager. Its lists were incomplete. Its judgments and conclusions were necessarily often based on incomplete and false data.

Time, experience and the momentum of long years, however, have remedied many of these defects, until now the commercial agency plays a most important and weighty part in the business world. It has realized that absolute disinterestedness and impartiality are necessary for the making of reliable ratings; it treats all, small and great, equally as to rating and service; its information is secured and judgment made therefrom, by the most experienced, careful and unprejudiced men.

The information which the agency affords is given in three forms: A quarterly book is issued by the agency, containing the name, the business, the capital rating and the credit rating of every firm or individual in this country or Canada that has established credit relations. The agencies supply no information concerning private individuals or such as do not follow a strictly mercantile calling. In the second place, daily sheets are published by the agency, in which are noted all failures or bankruptcies, new incorporations, the establishment of new business houses and changes in ownership. Lastly, the agency furnishes what are called special reports concerning any firm or individual engaged in business, on specific request from an agency subscriber.

SUBSCRIBERS *to commercial agencies receive rating books, daily sheets, and the privilege of special reports —the service of an organization of thousands of reporters*

Any business man may become a subscriber to an agency by the payment of a yearly subscription, in return for which he receives twice a year the rating book and the daily sheets; in addition, he has the privilege of requesting special reports on any individual or firm rated at a slight cost per report. Request for such reports must be made out on a special blank supplied by the agency, on the understanding that the information asked for is to be used for a strictly legitimate mercantile purpose, and for no other, and is to be kept secret. This pledge is necessary in order to prevent, so far as possible, those who are not subscribers from participating in the benefits of the agency's service, and to guard against the use of the information for some ulterior or malicious purpose.

A special report contains the detailed information

about a particular individual or firm: the character of the individual involved, as judged by his past history, life, habits and reputation; his ability, as judged by his business record and the present condition of his affairs; his wealth, not only that invested in the particular business under consideration, but any other property or interests which he may have; his debts, so far as they can be arrived at; his general social and business circumstances and connections—information on all these subjects is presented. Then follow details more particularly concerning the business in question, as distinguished from the man or men behind it: the capital, the outstanding accounts, the debts and their character, the amount and nature of the business done, the firms from whom goods are bought and to whom money is owned, the existence, if any, of secured creditors, and general statements regarding the business. The whole report is concluded by a general statement concerning the worth of the individual, the extent to which he can be trusted, and the manner in which he should be handled.

The credit man to whom this report comes sees not only the details presented, but his knowledge and experience tell him much more and enable him to read in the report facts not outwardly apparent, and to put the facts given into their proper relation. A special report is not intended to be a complete basis from which the credit man shall make his judgment; it is put in such a form that, combined with his own knowledge, experience and insight, he may reach a definite conclusion.

How is this information, given to the credit man in the three forms of quarterly books, the daily sheets, and the special reports, secured by the agency? To tell this it will be best to begin with the last, the special report.

The agency has an organization of thousands of reporters who are constantly gathering facts concerning mercantile houses. In the large cities of the country, where independent district offices are located, a force of reporters is constantly at work. The work is specialized in these large cities: one man has charge of each line of business in the wholesale trade, and the territory outside of the business center of the city is divided up into districts, to each of which a reporter is assigned. These reporters are kept at the same post for years and become thoroughly familiar with the detailed facts and conditions of their line of business or their districts, and with the houses and individuals in them. They keep track of and report to their managers the latest mercantile developments, tendencies, rumors, and even impressions, which they obtain.

Each of the district offices has sub-offices in lesser cities attached to it, numbering from two to eight, depending on the size of the territory and importance of its business transactions. Each sub-office has oversight over the territory around it, organizes it into reporting districts, and keeps track of its commercial affairs just as the offices in the larger cities do in their territory. Thus, the sub-office at Peoria, having charge also of certain smaller towns and the territory around it, has several reporters always attached to it, who constantly make the rounds of this territory, just as the city man does in his district.

In addition to these district reporters, the agency has in its employ in the majority of towns where there is neither a district nor sub-office an attorney, whose duty it is to report into the sub-office straight news items, such as failures, new businesses and changes in ownership, which cannot wait for the visit of the regular reporter,

and also to make special reports in urgent cases. These men do not, of course, give all their time to the work of the agency. Every hamlet and almost every mercantile business, regardless of size, is thus covered by this system of reporters and representatives.

CLASSIFICATION *of the work performed by the commercial agency reporters; the source of their credit information; how the territory is divided.*

The reporters make their reports regularly, the district city reporters daily, the country reporters periodically at longer intervals. The work they do, or the information they collect, may be divided into three classifications. First, they report the strictly news items which are used for making up the daily sheets. Such items, when they come up in sub-offices, must, of course, at once be telegraphed to the district office from which the daily sheets are issued. The agency has a telegraphic code of its own, which is always used in making reports of any kind by wire. This assures the absolute secrecy of the information and effects great economy in the expense of transmission.

Second, the reporters give an account of what may be called their impressions—that is, it may seem to them that a business is retrograding; that the owner or manager is growing careless; that the stock is being allowed to degenerate, or some man may tell them that his firm has put in a new line, increased its capital or made some other change. All these items appear in the periodic reports which the reporter makes.

The third duty of the reporters is to make the special reports which are called for. Thus, if a request comes into the Chicago district office for a special report on a merchant in Galesburg, and there is no recent re-

port on file in the office, this request is referred to the Peoria sub-office, in whose district Galesburg is situated, and a reporter from that office looks up the merchant and makes the report. Reports grow out of either a specific request from a subscriber, or, as is more generally the case when a new business is organized, the agency at once sends a reporter to get a report on the new concern, not only that it may have a report ready should it be called for, but also that it may insert the new house, with proper ratings, in the next quarterly book.

When these special reports come into the district office they are manifolded, and if they are of sufficient importance, that is, if it is probable that the firm investigated will seek credit in some other districts, a duplicate of the report is sent to those district offices, where they are kept on file and sent out in response to inquiries.

The information in the reports is obtained from two sources, direct and indirect. A statement is obtained from the individual or firm under investigation, who is asked a regular series of questions regarding his past history, capital, open accounts, debts, and so on. This information the reporter will judge, qualify and amplify from quick personal impressions which he gets concerning the individual and whatever part of the business he sees. Then some information is obtained indirectly, from other people, from the past knowledge of the reporter and the agency concerning the person in question, and from hints and impressions picked up here and there.

Of late years the custom has grown of obtaining the signature of the individual investigated to the financial statement which he himself makes. If this statement is proved in any later development to have been purposely falsified, the party is legally liable for obtaining goods

under false pretenses, since the acknowledged purpose of such a report, it is always understood, is to afford a basis for the extension of credit. The credit man who has such a signed statement before him in deciding upon the extension of credit has something tangible and sound to act upon, and his judgment is facilitated thereby.

The special reports kept in stock are corrected periodically—regularly twice a year. Except in special cases the agency does not undertake to give other than the stock report on hand when one is called for; nor is it expected, for generally special reports are wanted at once without delay; in most cases their value to a credit man would be lost entirely if there were more than a couple of hours' delay in securing them.

HOW *the work of the reporters is verified and supplemented by information secured from other sources; how business men's ratings are finally determined.*

The agency has other sources of information besides its reporters. In the district offices a force of clerks is constantly at work examining the state reports of incorporations and the court reports of bankruptcies, and even of suits brought against firms, for a man's financial standing can often be judged by the suits brought against him. Trade and financial publications and the newspapers are also examined carefully and systematically, and often afford information.

The facts thus obtained for the daily sheets serve as the basis and material for the corrections in the rate book issued by the agency in revised form every three months. As news of additions, changes or subtractions in regard to the business houses of the country are received, or as information warranting a change of rating comes in to a district office, the necessary corrections are

at once indicated on the last rate book, and at the end of every three months these corrections are gathered together and a new book incorporating them is issued.

Two ratings are given in the rate book for each business house rated—capital rating, which indicates the approximate amount of capital invested in the business, and the credit rating, which is the judgment of the agency as to the confidence which can be placed in the individual or firm rated. These ratings are usually indicated, not by figures or words, but by short abbreviations. The absence of either rating opposite any name does not necessarily indicate a very poor condition, but merely means that for some reason or other the agency has not been able to obtain information upon which to base a judgment.

How are these ratings made? This is the delicate and most critical point in an agency's business. The capital rating does not merely represent the statement made by the interested individual himself to the agency reporter; it is not even the amount of cash known to be invested in the business, nor, if it be a corporation, the amount of the nominal or paid-up stock. The capital rating is really the judgment of the rater as to the amount of commercial value or the par value of the assets which the firm rated may be considered to have in its business, all things regarding the firm and the business taken into consideration. The capital rating really purposes to estimate what this business is worth in money, its realizable net value. The invested capital or the capital stock of a firm may remain unchanged from year to year and yet its capital rating may be changed time and again in the agency's quarterly book during this time.

In like manner, the credit rating does not merely indicate a certain fixed percentage of the capital in-

vested for which the average business man may be considered good. This rating, even more than the capital rating, is the judgment of the rater, all things considered, as to the confidence which can be placed in this man or firm. It is the result of a careful study of this man's character, his present social and commercial condition, his business history for a score of years past. It is the rater's opinion of the man's integrity and resources expressed in terms of money.

That the commercial agency fills a need and occupies a legitimate place in the business world is proved by the immense expansion of its functions and activities in the last half century, the vast extension of credit operations in the same period, and the trust and confidence reposed in it. This description of its internal organization, its scope and its volume of detail is the best evidence of the place it fills in the credit world; it is the most indispensable, the oftenest used and the most versatile tool with which the credit man is equipped.

A MAN *who aims at business success must become a master of system. A business man without system is like a ship without a rudder. System not only helps you to steer your business craft on a straight course, but increases its speed. It saves time, it saves waste, it insures accuracy and dispatch. With system there is almost no end to what a man may do; without it he is a slave to detail, confined to the narrow limits of his own hands.*

—Walter H. Cottingham
President, Sherwin-Williams Company

IV

CREDIT INSURANCE

By T J. Zimmerman

CREDIT insurance is the application of the principles of indemnification for losses to the risk incurred in the extension of credit for merchandise sold. In the theory of its present practitioners, it is a guarantee to reimburse a business man for losses sustained from bad debts over and above a certain specified normal amount and within agreed limitations.

In the treatment of this subject, consideration will first be given to the premises on which the idea of credit insurance is based. A description of the plan and method by which it is actually carried out in practice, and a discussion of its merit and value, its deficiencies and weaknesses, as thus practiced, will follow.

The soundness and legitimacy of the general principle of insurance have been established. The foundation underlying all insurance is the same. It is an arrangement by which unexpected and incomputable burdens and losses are equitably distributed among a large number. An associated group of men affords to each of its members protection against unlooked-for casualties; each must pay for having his risk assumed by the others; the official organization or company is simply the agent to collect the premiums and distribute the losses. All insurance is based on the law of averages. Nothing is so

uncertain as the future loss on a specific risk, nothing so certain as the average future loss on all risks. Insurance is based only on unexpected losses, such as cannot be computed in advance. Thus, insurance on property, called broadly fire insurance, insures against fire and at times, loss by cyclones, floods and other catastrophes; but it does not insure against regular wear and tear, depreciation or a decrease in the value of goods. Insurance applies only to risks, not to specific circumstances. All possible precautions are of course taken against such unexpected loss; buildings are built as nearly fireproof as possible, and provided with all kinds of appliances for extinguishing fires, regulations are enforced regarding the storing of inflammable material and the operation of dangerous enterprises; efficient fire departments are kept up; care is even taken to guard against incendiarism. Yet risk remains, and while these precautions lower the risk, and hence the cost of protecting the risk, it must be insured against.

INSURANCE *of losses beyond the amount expected in the ordinary course of trade defines the scope and the principle underlying credit insurance.*

Credit insurance has all the earmarks of fire or life insurance. Business operations to-day rest on credit. All credit operations involve a chance of loss, for any exchange of money or goods in which both parties do not deliver their commodities at the same moment, entails some risk to the party who delivers first.

Now, the business man of to-day, working against the most pressing competition and on a small margin of profit, must know his exact costs and expenses. His cost estimates must be so carefully computed that he can be absolutely certain, if he sells at a certain figure, he will

make a certain profit. Other things being equal, his success will then depend on two factors: the accuracy of his cost calculation and his protection against unexpected losses. His losses can be of two kinds: losses incurred while his goods are still in his possession, that is, by fire —this every business man will guard against by carrying fire insurance; and losses incurred after the goods have left his custody, that is, through bad debts made by extending credit. What more logical than that this risk, too, should be protected by insurance?

In both property and credit loss there is a certain normal which the business man charges into his cost account. Thus, necessary and unavoidable depreciation in buildings and stock is taken into consideration in estimating total expense, and among the many charges of care-taking and wear, are included fire insurance premiums. This cost will vary with the kind of business and its management, but the merchant knows from his previous year's record exactly what these items will amount to. In the same way there is a certain normal for bad debts, varying little from year to year, depending on the kind of business, the class of customers dealt with, and the perfection of the organization in charge of the credits. This normal loss, averaged from previous years' figures, as unvarying as depreciation, is properly part of the expense of doing business, and must be figured in with total production costs. A certain prefigured normal loss is really not a loss at all; it is not felt in the business; it is expected and provided for like a weekly pay roll.

But, in addition to this, business done on credit is always open to unlooked-for excess losses beyond the natural expectancy in the ordinary course of trade, just as it is liable to unexpected property losses. The na-

tural sequence is that this excess loss should be insured against just as is excess loss on a firm's property. Fire insurance, then, protects goods when they are in the possession and title of the seller; credit insurance protects them when title and possession have passed to another, without an equivalent having been received. The basis of both kinds of insurance is the same, the law of averages as applied either to fire or to bad debt losses, and the data for both bases are gathered in the same way and from equally reliable sources—they are the general experience and exact average figures of the past combined with specific facts relating to the individual risk under consideration.

The banker who, with $1,000 to loan, and the choice between a 7 per cent interest with poor security and a 5 per cent interest with gilt-edge security, takes the latter, probably does not realize that he is paying 30 per cent of his possible profit for collateral, and he feels and knows that he is getting value received. Or, putting it in another way, he is paying $20 a year for insurance on this loan.

The credit insurance company stands in the same relation to the merchant as the indorser does to the banker. Credit insurance affords collateral on every bill of goods sold by a merchant on credit. In sending out a consignment of goods on credit, a house is really loaning money to the amount of the value of the goods; the insurance company puts up the collateral on this loan. Just as an indorser investigates the condition of a man on whose bond he goes, so the credit insurance company investigates the firms on whose credits it affords insurance, except that it does this by a different method.

The plan of credit insurance, therefore, is based on the principle that there is always some loss from bad

debts in every business; that, while in no specific case can the excess loss over this normal be calculated, it can be averaged for the aggregate of a large number of houses, and that, consequently, this excess loss can be insured against.

This is the idea, the principle, of credit insurance. How is it carried into practice? What is the actual method of operation of credit insurance companies of to-day?

METHODS *used by credit underwriters to investigate insurance risks; how normal losses, the amount of the bond and the premium rate are determined.*

When application is made for credit insurance, an underwriter at once takes up the investigation of the risk, just as in fire insurance an underwriter investigates the condition of the property to be insured. Three decisions are to be reached: What sum is to be fixed as the normal loss of this house, above which losses will be indemnified; what is to be the per cent and fixed limit of indemnification, and what is to be the premium per year?

The mercantile agencies have through their long investigations gathered together a mass of reliable and valuable data, relating on the one hand to general facts, on the other to specific business concerns. Such careful statistics of failures have been compiled that the commercial mortality, classified according to different businesses, different localities and different commercial conditions, is as thoroughly understood and tabulated as human mortality or average fire loss. These statistics the insurance underwriters have at hand. In addition, the mercantile agencies can give them specific information regarding the house in question—the general con-

dition of the house, the character of its trade, the class and location of its customers, all bearing on its credit conditions.

Finally, the house itself is investigated from the inside. It must show a schedule of its losses during past years. The books are examined to determine the class of customers, the volume of business, the size of accounts, the terms on which goods are sold, the general credit policy and the run of collections. The real determination of insurance terms depends on these elements of live hazard entering into the policy. From all these facts, the normal loss, the amount of the bond and the premium rate are determined.

For clearness let us cite an imaginary case: The gross sales of a house amount to \$400,000; the normal loss is placed at one-half of 1 per cent, \$2,000; the bond taken out is \$10,000, on which the premium is 4 per cent, \$400. In this case, if the aggregate loss of the house from bad debts is under \$2,000, the firm recovers nothing; any excess loss over \$2,000 up to \$10,000 is recoverable in full, within certain restrictions. These restrictions are regulated by the credit standing and capital of customers to which a firm extends credit. "Rated" customers—that is, those having a capital rating followed by a first or second credit rating—are covered for 100 per cent up to an agreed percentage of their capital; "off-rated," those having a lower rating than the former, or none at all, are covered for only a part of loss sustained through them, up to the same capital percentage.

Such is the present operation of credit insurance. Is it to be recommended for the use of the business man of to-day? Its followers allege many advantages. Credit insurance gives the business man control over his costs; secure through his insurance from excess losses, he need

merely add his normal loss and his premium to his other fixed expense items to ascertain the exact production costs. He can thus compute his profits with absolute certainty. The last unknowable hazard is wiped out. He knows his resources exactly and what he can count on, since his book credits, formerly a doubtful quantity, are now a recoverable asset. The certainty and assurance which this condition of affairs gives him allows him to build more securely and farther into the future, and to meet competition fearlessly and aggressively. He can figure more closely, having more certain knowledge of his costs; not having constant worry of bad debts over him, his mind is clearer and cooler.

ALLEGED *advantages of credit insurance in actual operation; increase of sales, admission of wider opportunities, promotion of the credit man's efficiency.*

The inevitable tendency of such a policy will be to increase sales in so far as they emanate from the credit department. Not only will the credit man be able to extend his credits in some directions—not in all, as will be explained—become more fearless and embrace wider opportunities because he has someone with whom to divide responsibilities and losses, but he will worry less and hence be more fit for his work. Once a decision is made, if the credit extended complies with the terms of his bond, the credit man knows he can sustain no loss. And if an unexpected and unavoidable loss falls upon the house, he will not—as often happens—go to the opposite extreme of ultra-conservatism and turn down many good orders.

The insurance policy, rather than making a credit man careless, forces him to keep closer watch of his customers and their accounts, and so tends to better his

credit-making, since, to avail himself of the insurance offered, he will live up to the requirement of his bond. He must watch the changes in the capital and credit-making of his customers, for the insurance coverage is based on the latest information concerning these fluctuating items. He must keep close watch of the amount of credit given, as shown by his ledgers, for insurance ceases above a certain sum. The bond thus serves as a guide in making credit. Its requirements will also make him keener on collections, more strenuous in holding customers to prompt payment—in itself a guard against loss—for he may not be able to grant further credit and be protected on it until back bills are paid up. The credit man's eagerness is thus held inside the danger line, and carefulness. the very opposite of recklessness, is induced.

A further curb on the credit man's eagerness is the fact that he always has the endeavor to keep his losses inside the normal amount, for now more than ever will a small percentage of loss redound to his credit, for it will be pure surplus for his house, inasmuch as the normal loss has already been calculated into the cost estimate. And he will not lose sight of the fact that on his present year's record will depend the amount of his future normal loss and premium rate. He will, furthermore, always prefer to collect from the debtor rather than the insurance company, for, as in fire insurance, a loss means much more than the money involved; it carries with it the trade of a customer, a stain on the credit man's record, a black mark against his house.

The value of credit insurance must depend largely on the man; its weak points appear plainly in the very presentation of its advantages. It can be abused much more easily than well used. To a credit man the least in-

clined to shirk his responsibility or take too long a chance it will prove fatal and against the best interests of his house. The very fact that he is dividing responsibility and putting the possible loss on someone else will make him more lenient in granting credits. The specific facts in regard to a customer which the credit man must watch to keep within the requirement of his bond are not extremely significant; the bookkeeper or office clerks can keep track of them. And a credit man carrying insurance may even disregard them altogether, figuring that he can take the extra chance even though his credit extensions are over-stepping the stipulations of his bond. None of the arguments advanced as curbs on the caution of the credit man will stand examination. The credit man's house will not be liable to hold a loss from bad debts against him if it is covered by insurance, provided he can show that he has increased sales by taking this chance. Credit insurance companies themselves are compelled to confess that business men using their policies are apt to try to make money off them. That a high loss one year will raise their future normal loss and premium rate will not be likely to worry credit men. In short, the weak credit man is quite likely to be further weakened by carrying credit insurance and to substitute the security of his bond for good judgment.

It is often questioned if credit insurance, as now conducted, has any value to the strong, able, watchful credit man, and whether it does not constitute a burden on him for the benefit of his weaker brother. Under the present insurance policy the credit man really does not make his own credits, and does not, therefore, make credits on a proper basis. On the one hand, if, hesitating to grant a doubtful credit, he does extend it because the case is covered by his bond, surely in this case

it is not his judgment, but the protection of the bond, that makes the credit. On the other hand, refusing against his own better personal judgment to grant credit because such extension will for some reason not come under his policy requirements, here again it is not he who is making the credit.

If the normal loss of a large firm for a long period of years has averaged a certain percentage of its gross sales, it may well wonder why it should pay out a considerable sum of money to be protected against a loss above this normal, for it is extremely probable that, even though in some one year its losses will exceed this percentage, the average of the next decade will be no higher, and its premium will only be so much additional to be charged to the loss account.

But these arguments are all against the present methods of operation in credit insurance, rather than against the principle itself. It is the methods of credit insurance companies of to-day that have come under criticism; faulty methods due in part, perhaps, to the fact that the movement is still young and that underlying principles and operative methods are still in an unsettled state, but also to what many consider the inherently wrong basis on which they are conducted.

WEAK *points and dangers in credit insurance—difficulties in carrying out the theory, the doubtful value of credit insurance in preventing panics.*

The great trouble with the present methods, and the reason that they have received so little commendation from thinking men, is their generality, a characteristic which destroys almost entirely their analogy to fire insurance. In the latter, the companies do not divide risks into a certain number of classes and place each piece of

property insured in one or the other of these classes, but each risk taken is carefully investigated in itself and special regulations and figures applied to it. The fire insurance company knows exactly what it undertakes in every case.

If the credit insurance companies did the same, that is, if, when a credit man was considering the extension of credit to a certain applicant and wished to be secured on the risk, the credit insurance company should come and investigate the risk, determine whether or not it wished to take it, and name a premium rate specific to this one risk, then the insurance would not interfere with the credit making of the credit man or even with his judgment, nor would the insurance company be working in the dark, as it virtually appears to be now. It seems absurd that the insurance company should take the ratings in the rating books as its foundation for operation, ratings which not even the publishers of these books themselves will guarantee, and which every credit man verifies before he accepts.

Much is claimed for credit insurance as a stimulator of confidence in trade and a preventive of panics. Since the wide expansion of credit operations, business prosperity has doubtless been based on confidence in the financial soundness of the debtor classes, confidence in the return of money for goods sold. Confidence, although more intangible, is as real and important a factor in business operations as the banking system itself. Anything, such as the guaranteeing of an account, which will give to confidence a tangible basis, and will do away with that fecund cause of panics defined by the term, "the bottom dropping out," by preserving confidence and hence credit between seller and buyer, and will thus keep trade stimulated, is to be commended and en-

couraged. Not only this, but should a depression come, it is claimed its worst effect, losses through outstanding accounts, would be nullified by the indemnification of credit insurance.

Were it wholly true, as an admirer recently eulogized it, "that credit insurance weaves a mesh of tough fiber, confidence, which permeates the entire crystallized structure of our commercial body, giving greater strength and cohesion to withstand a strain," then it might unqualifiedly be called a public institution working for the public good. But a panic is what the name signifies. It would be just as easy for the business world and the individual creditor to lose confidence in the resources of the insurance company itself, as it now is to lose confidence in the debtor, and the resultant crash would be infinitely worse. For, since credit operations would become even more extended under a credit insurance regime, the liquidation following a possible loss of confidence would be correspondingly greater. Considering that losses from bad debts in the last decade have approximated two billion dollars, to realize such an ideal as that painted in the statement quoted would require an institution of almost incredible capital, power and prestige.

IF I *were asked to name the one qualification most needed in the collection department I should unhesitatingly say "decision." Indecision in the credit department is often dangerous, while in the collection department it is frequently fatal to the business.*

—Dorchester Mapes

V

WHEN AND HOW TO MAKE COLLECTIONS

By Harlow N. Higinbotham
President, The National Grocer Company
Formerly Credit Manager, Marshall Field and Company

WHEN the credit man decides that the time has come to withdraw credit from a customer, he is usually confronted with the difficult problem of getting in the balance due.

In extending credits and in making collections there are few established rules to follow. Experience, sound judgment, a knowledge of human nature—these must take the place of rules. Each case presents its individual problem. The settings and the combination of circumstances surrounding it may be wholly different from anything the credit man has encountered before. Frequently a special campaign is necessary; each creditor must be approached from the angle most likely to impel him to pay. That is the credit man's most important work—to get in the money, especially when it is time to close the risk.

How little the credit man can rely on regular methods, and how largely he must depend on his own judgment in getting a correct line on a suspected customer, was shown in my experience with a customer who owed my firm about $5,000, and whose increasing slowness in taking care of his bills led to the suspicion that his business was not prospering as it should. I went to his city, quietly, and did some reconnoitering. Without asking

direct questions or disclosing my purpose, I talked with various persons in the town. All the information was in favor of our doubtful customer. He stood high in the estimation of the local public, especially with the church people. He was active in religious affairs, Sunday school conventions, and the like. The banks regarded him as a substantial business man.

But all this did not offset the fact that he was getting slow in his payments, nor did it shake my conviction that it was time to collect. The fact that he was so active in religious affairs strengthened this conviction. Even the church may be a diverting influence which the credit man must take into account, for when a merchant becomes extremely active in church work, he is liable to neglect his business. If he is independent and out of debt, this is his own affair, but when some one else is carrying him, it is different.

HOW *an opportunity was created to secure valuable first-hand information concerning the exact condition and prospects of a customer's business.*

In the basement under our customer's store was a barber shop, and I reasoned that here would be a good place to get reliable information about the condition of his trade. I knew that the noise of feet and the handling of goods must be plainly audible below.

So I took occasion to be shaved. As I sat in the chair, I brought the conversation around to the subject, in a casual way, and discovered that the barber had a well-defined opinion on this very question.

"I reckon," he said, "that the church and Sunday school business is better than merchandising. I used to hear a lot of tramping upstairs, and a lot of thumping of goods on the counters, but things are pretty quiet up

there these days. There aren't many crowds."

Here was confirmation of my own opinion. The pieces of goods were not being thumped down from the shelves as they had been in the past. The merchant's interests were elsewhere and much of his trade was also elsewhere.

I went back home and wrote this customer that he must pay us in full. He came to see us at once, very indignant, and when I refused to give him further time he went directly to the head of our company, only to be promptly referred back to me without telling him the reasons. I firmly insisted upon a settlement.

Within a day or two I received a call from the merchant's local banker.

"I want to know why it is," he said, with a show of importance, "that you refuse credit to Mr. Hilton. He is one of our most substantial merchants. Everybody in our town has the utmost confidence in him. He is a leader in church and Sunday school affairs, and takes an active part in conventions and that sort of thing. If you would investigate a little, you would reconsider your attitude."

I did not tell him that he was arguing my own case—and there are many such times when it is hard for a credit man to keep his reasons to himself. The banker had better facilities than I for sizing up this man; he could have seen that his business was on the decline and that the merchant himself was becoming unduly important to the town and not important enough to his store. But the banker was deceived because his credit sense was not keen.

"I am glad you think so well of him." I said; "Undoubtedly you are in a position to know. But we need the money. We'll have to ask him to pay his account, and no doubt he can raise the cash at home without any

hardship. Your own bank, I presume, would let him have it."

"Yes, it will!" he exclaimed. "And it's absurd that a house like yours makes such a thing necessary."

So he went back home and loaned Mr. Hilton $5,000 with which our bill was paid. But before Hilton paid the loan he failed. The banker could not interpret the handwriting on the wall; he made the common mistake of confusing good fellowship and good pay.

This incident illustrates the desirability of obtaining information quietly, of analyzing it, and of keeping it to yourself.

The credit man should draw an imaginary circle about each customer. A circle may be only a mile in circumference, or it may be several hundred miles, but it represents the sphere of the customer's activities. Everything within that circle having any bearing on a customer's business, should be recorded on the credit man's cards or in his brain. No limited range of information will suffice, for it is only by knowing all about a man that you can judge him accurately. I knew many of my customers intimately; not only their business affairs, but how many children they had, how many times they had been married, what their diversions were, what place they held in the church, may many horses they kept. All these things are credit assets or liabilities, and the sum of them tells the credit man when to draw the line and collect the balance due. Often I secured this information by personal visits to the towns where doubtful customers were located. And often mere straws told me which way the wind was blowing.

Once I went to a town where a merchant owed us $1,000. A brief observation of his business convinced me that his trade was falling off and his enterprise waning.

I felt certain that he could not keep his head above water very long, although nobody told me so and I asked no direct questions. I knew that if I gave the alarm we would lose our money, so I merely said to him, "Jones, we need the cash but we don't want to embarrass you. We are not going to draw on you for any large amount at one time, but we are going to draw as often as we think you can pay a fifty-dollar draft."

I went home and got out the first draft, which was paid. In a few days I drew again. Jones dug down into his cash drawer once more. He did not want to refuse so small a draft. In this way I kept working the indebtedness down, and Jones, expecting the little drafts, was bending all his energies to raise money enough to meet them. Meanwhile, he was buying from hand to mouth of other wholesalers who had not yet sized up his affairs. He probably reasoned that the promptness with which he met our drafts gave him standing at the bank—the confidence of a banker is usually the first concern with a merchant whose credit is getting shaky.

Luck was with me and he lasted just long enough to clean up the final fifty-dollar draft.

SHREWDNESS ***in sizing up an account depends upon close familiarity with trade conditions, the faculty for discovering evidence of declining business.***

To the layman a credit man's tact and shrewdness in sizing up actual conditions would seem to be largely intuition, but in reality it is a finely developed capacity for observing and interpreting the signs. To sense the actual condition of a business, the evidence of development or retrogression, requires more than second-hand information. Elaborate reports based on the opinions of men who are closely associated with a merchant are quite

likely to be inadequate. Those who see and know the doubtful risk at short range are easily influenced by personal appearances. The credit man should not be guided by reports, against his own convictions. Of course, he cannot visit all his customers personally, but he can gather a mass of information about them that does not come in the regular channels. First, he should know the detailed resources of the town in which a customer is located, and the country surrounding that town. He should know the population and the different classes of people; he should know what competition his customer has, and so forth. Among these things the previous history of his customer is very important, for if he has moved to the town from some other state or locality, he may be a misfit.

I recall an instance where a merchant was out of his element. He had gone from Michigan to a state farther west. His ideas were not in harmony with his new field of activity. He thought himself too big a man; he was altogether too pompous and important. Especially from this, as well as other things I learned about him in his new home, I decided that he would make a failure of his business. I asked him to settle his account, and he came to Chicago; he walked past my desk with a haughty air, and went to an authority he thought higher. But he discovered that I was the credit man, and I got a settlement out of him before he went under.

Luck sometimes plays a part in collecting doubtful accounts, but what most people call luck is more often a shrewd insight into things. I remember a customer in Michigan whose account with us had reached $5,000. He was getting slow, and I went to his town to see what the trouble was. I found that his business was in bad shape and that our account apparently stood a slim chance.

The only clear property he had consisted of a tract of timber land in the northern part of the state. This was in the early days when lumber was almost a drug on the market and nobody realized the prospective value of such lands. Perhaps I did not fully realize it myself, but I had lived in the district where the land was located, and had formed my opinion as to its future. I offered to take the tract and cancel the debt.

To all appearances, the merchant was getting much the better of the transaction, and he was glad to avail himself of the opportunity to get out from under his load so easily.

I held this tract in my own name for ten or twelve years, when we sold the wood on it for $90,000. I looked up our old customer and found him infirm and in poor circumstances, so I gave him five thousand dollars in cash. Then he turned around and sued us for the balance, but, of course, he lost his case; for no doubt this property would have been divided among his creditors at the time of his failure for much less than we gave him for it.

This incident merely illustrates the fact that a credit man must be more than a clerk or employee; he must have his business sense acutely developed, and his knowledge of affairs and values must cover a wide field, for not every settlement leads directly to the cash drawer.

INSTANCES *that show how the credit man's alertness and quick action at the critical moment prevented bad accounts from becoming total losses.*

It was a little piece of collection work that first established me firmly as a credit man. A certain merchant in a small city owed us $650 that we seemed unable to collect. The man in charge of credits at that

time sent me to see what the trouble was. I had no definite instructions, but I was on my mettle and was determined to do the best I could. First, I spent some time walking about the town and sizing it up. I went into all the stores, noted the trade they were doing, and made an excuse to talk to the merchants without letting them know my business. Then I went to the banks and introduced myself, merely saying that I was on a collection tour for my house, and asked commonplace questions about the different merchants. I laid no emphasis on the particular retailer I had in mind, but I learned that the bankers considered him good and were willing to discount his notes.

I was convinced, however, that the dealer in question was not solvent, or, at least, was not doing the business to justify our line of credit with him. I did not like the appearance of his store nor the way he was handling things. I went to him and told him we must have our money. He said he could not pay—which I knew perfectly well. Then I drew up three notes, at thirty, sixty and ninety days respectively, and he signed them. These I took to one of the banks, indorsed them without recourse, and discounted them. So well did the merchant stand in the banker's opinion that he accepted the indorsement without complaint when I made it plain to him that he was buying his fellow-townsman's paper, not that of my own firm.

I took the money back to Chicago with me, and it was not long afterward that I heard of the merchant's failure.

This instance shows the necessity of looking at credits from a broad standpoint. The viewpoint of the local bankers was at close range; they judged the man's risk without any analysis based on facts.

In another case, I was confronted with the collection of forty-five hundred dollars. This merchant owed another wholesaler more than us. I found when I arrived in the town that a man from the other house had made an effort to get money, but had contented himself chiefly with promises.

After analyzing this man's business and especially the methods under which he was operating, I made up my mind that the time had come to collect, if we hoped to do so at all. I told him we must have a settlement. He said it was impossible—that the people who owed him would not pay, and he must have more time.

Then I offered to show him how to get money. "I'll stay with you," I said, "until some of these people do pay."

He was glad to have my help. I went into his store and made myself a part of it, got acquainted with some of his biggest debtors, and induced them to give him their notes. I went out in the country and hunted up other debtors, taking their notes also. Under his authority, I collected each wherever I could. Nobody in the town, except the dealer himself, knew whom I really represented. Among other things I did was to find a buyer for a stock scales and yard attached, belonging to my debtor. I had observed that it was a poor venture, for while it returned ostensible dividends, it consumed a large share of this man's time and attention. For this I secured $1,500. He was quite willing to sell the property when I made it plain to him what its possession really meant to his business.

I stayed a week with him, and when I left I had collected almost enough, in cash and notes, to settle the account. To make up the balance, I persuaded him to return certain goods.

This merchant, like the others I have mentioned, failed within a short period.

These instances illustrate the necessity of the credit man to be continually on the alert, to watch and analyse the movements of customers with past due accounts, to know the important details of their business and private life, to rely upon personal observation to size up the extent of safety or danger. It is only through a close personal knowledge of the customer's affairs that the credit man is able to detect the signs of declining business and to collect the balance due before the sheriff steps in.

IT MIGHT *be supposed that through the improved methods of credit making, the credit man has become hard and distrustful, but this is not a true inference. Credit is dispensed today as liberally as ever, but it is a more intelligent dispensation. By cutting off the unworthy from credit, the credit man is in position to extend it to the worthy more than ever before. The curtailment applies to those who are not entitled to credit, and it is from this source that is estimated the decrease in losses.*

—Peter R. Earling

Chairman, World's Congress on Credits and Collections

PART II—CREDIT POLICIES

Credit—and Character

ALL the stocks and bonds dealt in on all the stock exchanges of the world, all the huge national debts and state debts in the world, all the tremendous international trade balances one way or another, all the bills and accounts receivable on all the ledgers of the world, and very nearly all of what is called money in the world are only different forms and expressions of this wonderful thing named "Credit".

Credit starts enterprises, moves wheels, builds railroads, wages wars, makes civilization. The modern business world lives, moves and has its being in credit.

The word credit comes from *credo* (I believe), and every transaction performed by credit involves the belief on the part of one man in the integrity and character of another man.

Character lies at the very foundation of modern business and no business can long endure that is not built on that foundation.

David R. Forgan.

DAVID R. FORGAN

President, National City Bank of Chicago
Vice-President, Chicago Clearing House Association

VI

WHOLESALE CREDITS AND COLLECTIONS

By Howard R. Huse

IN extending credit in a wholesale house, character, estimated worth, volume of business and expenses, are the conditions taken as the basis for accommodation. If a man is lacking in any of these, experience only will indicate to what extent his account is desirable.

In getting the information necessary to determine whether or not credit should be extended, the credit man has four principal sources open to him. These are, agency reports, exchange trade information, local reports and information from salesmen. The systematic and satisfactory way of making credits is to combine the information from all these sources.

The use of mercantile reporting agencies offers one of the best means to secure information. Local attorneys and banks, if they are treated fairly, can usually give good first-hand knowledge. Their information, however, must be carefully analyzed and should generally be discounted. Their reports are written from a local point of view which is often partial either toward friendliness or hostility.

Besides these sources of credit knowledge, the salesman offers a unique opportunity for getting first-hand information. As he is in actual contact with customers, he can find out their standing in the community, how

they are looked upon financially and socially, what their reputation for character and integrity is—he can observe the customer's method of managing his business, the character of his patronage and the amount of his stock; he can determine whether or not the customer is overbuying and can advise against it.

In order to secure this information from the salesman, the wholesale house credit man should, as far as possible, let the salesman know the policy he is pursuing, his methods and purposes. He should teach the salesman what kind of information he wants and why he wants it, what credit information consists of and how a man is to be approached in order to get it. Furthermore, he should make clear the fact that it is a part of a salesman's duty to express his opinion of the risk on each order he gives. Thus, if the salesman is given to understand and knows by experience that his judgment is to be a determining factor, he will take pride in making it reliable. It flatters the salesman to know that his opinion is of some weight. The fact should be impressed upon him that this is a part of his work, that the sale is not complete until he has expressed his judgment of the risk.

Extension of unwise credit to applicants with bad or unfavorable records can be avoided by using ordinary care and industry in getting information. Credits extended to this class of customers are past rectifying and inexcusable. Sagacity is not needed in passing on customers with bad records nor on customers who have very high ratings, but between the two extremes of good and bad are ninety-eight out of every hundred cases which come before the credit man. These cannot be classed among the discreditable nor yet among the unquestionably good. As a matter of fact, the great majority of

men to whom the wholesale house sells have for their principal capital only experience, energy and more or less capital. Their success is contingent on times and circumstances which they cannot altogether control and the creditor is obliged, therefore, to take a joint risk with them.

> LIBERALITY *in granting credit is based upon the fact that most business men are honest and is essential to the growth and popularity of any business.*

In dealing with these cases, there is a fundamental principle by which the credit man should be governed. Except for the few notoriously bad and dishonest business men, he should assume that his customers will pay if they can, even though as an abstract proposition they may have no definite notion of honesty or commercial honor. Every man nominally must make a living for himself and his family. He selects this or that business as being best suited to his circumstances and experience. He invests what little money he has saved in it. The success of his business is everything to him. He understands it better than he does anything else and the work is easier for him than any other. He has learned and knows that he can continue this business on one condition only—that he pay his creditors and with reasonable promptness. Honesty and good commercial usages commend themselves to him as being necessary, or in other words, he realizes that honesty is for him the best policy. Business men with rare exceptions follow this line of reasoning.

A liberal policy in credit making is necessary for the growth and popularity of the house. To be popular is next to being successful. The most successful houses are the most popular the world over and vice versa. The

wholesale house credit man should endeavor to gain popularity for his firm and a name for liberal treatment.

A new account open, the credit man has not disposed of his subject. Not merely a first order, but every succeeding order requires careful investigation and consideration. The difference is that while investigation on a first order must be done at one time, specifically, succeeding orders must be watched carefully and judgments based upon previous experience with the customer.

The frequency with which special reports should be obtained depends upon the customer's line of credit and the conditions of his account, but all information should be revised at least once a year and oftener when the risk is more than ordinary or when an increase of credit or an extension is asked.

The interchange of knowledge and ideas necessary between the collection and credit departments in any house makes them almost inseparable. In order to make credits safely, a credit man must have the knowledge which comes from an oversight of collections. To make collections intelligently the collection manager must possess the information and experience acquired in making credits. Injustice to customers and losses to the house would arise were the two departments kept entirely separate. The continuance of credit to a customer depends not only upon his responsibility, but upon the manner in which his account is cared for. If the credit man has his finger on collections, he can make credits in less time and more accurately, and the collection manager fresh from the making of credits can conduct the collections with less expense and less friction.

Delinquent customers are divided into several classes, careless, chronically slow, temporarily hard-up and in-

solvent. To decide which classification fits any individual is one of the most difficult problems of the credit man since the classification determines the method to be used in collecting the account. The strictly correct solution in dealing with overdue accounts would be to ignore possible conditions altogether and to take peremptory steps to get the money, but there are two protests against this procedure. In the first place, it is contrary to policy to drive away a customer who may be solvent by too rigorous methods, and in the second place, this method is expensive. Furthermore, to enforce collections at this uncertain stage might be an injustice to the debtor. So long as the credit man can assume that the customer is good for eventual payment, the best policy is to use the coaxing process. At least, while there are extenuating circumstances, the credit man is forced to forbearance and leniency from any standpoint from which he may look at the case.

THE *course to pursue in making collections; securing information concerning the debtor's business; how to educate customers into prompt payment.*

The first thing to do when an account is past due and demand for payment has been refused, is to get all the information possible concerning the debtor. The collector should look up the report on file or have reports procured. This will give him an idea of the debtor's capital, resources, and other details, and is a help to him in handling the case.

When an account becomes past due and remains unpaid after proper efforts have been made to collect, the collector has an acknowledged right to ask for and demand information concerning the debtor's business. Under these circumstances the debtor cannot refuse the

demand with justice, and if he does so, his action is open to suspicion at once. This information should be comprehensive and should state what the assets are composed of. A statement of liabilities is also essential. A knowledge of these facts and of the general character of the debtor himself places the collector in a position to determine intelligently whether it is safe to extend further time.

The most important thing is not to collect money after it is due, but to educate customers to pay bills when they mature. A bill should, of course, be sent out with each shipment. It is well to send statements on the first of each month to all houses whose accounts bear a great variety of charges each month, and who discount their bills. If bills are not paid before maturity, there is no better way of educating customers than by rendering statements on the very day their bills mature, notifying them of the fact, and stating that unless they remit, or ask some other form of settlement, draft will be made upon them within a certain definite time. The practice of sending out statements on the first and fifteenth of each month for accounts which are to mature during the next fifteen days destroys the chief value of a statement, which is to bring to the attention of the debtor the fact that his bill is due now and that remittance is expected. The best day on which to remind a man of this fact is the very day on which his account matures.

The notification that a sight draft will be made on debtor if his account is not paid will give no offense if accompanied by the saving statement, "unless other form of payment is desired." This gives the debtor the opportunity of sending his check in payment, or asking for an extension or some other settlement than a sight draft. If, however, neither payment nor explanation of

any kind is received, the credit man should always draw the sight draft on the day fixed. It is not good business policy to tamper with a customer's feelings. Do what you say you will do. Let him know and comprehend the policy and methods of the house by inference from their constant and regular operation. On the other hand, if a customer complains that he does not like that manner of settlement, the credit man should never let a complaint pass, but should always notify the customer that he will be glad to adopt any reasonable method of settlement suggested, and then demand that the customer live up to his own proposition.

If consistently followed, this method of drawing sight drafts is not offensive to customers, especially the country trade. Many of these do not keep ledger accounts with their creditors. They depend solely upon the bills and statements which they receive. They check up the goods when received with the original bill, and stick it on a spindle. When the statement comes, they check it up with the bill, and either remit at once or prepare to honor the draft. This makes a very simple method of bookkeeping for them and obviates the necessity for keeping an account. The original bill is their book account, the statement is their reminder, and their own check or the draft returned to them by their bank is their voucher receipt.

If a sight draft is not paid when presented by a local bank, the draft may in some cases be presented again; and if then refused, the customer should be asked for an explanation. By using the ledger system described, the dates of these operations and comments can be noted by the bookkeeper, so that the transactions can be followed systematically and a record preserved.

The course of action to be pursued after the second

refusal to honor the draft depends upon the value of the account, the credit man's experience with the customer, and his financial condition. It is at this stage that heart to heart letters are very telling. Nothing appeals to a man like presenting a case to him plainly and truthfully, in an open, fair way. "Why," the credit man may ask him. "cannot this house demand the same promptness in payments from a customer as the latter demands from the house in filling his orders?" A business man likes to be fair, and if it is proved to him that he is being treated fairly and that he is asked merely to do the right thing in return, it is rare that he will not respond.

Nothing is more fatal than to allow overdue collections to drag along. When a customer has not asked for an extension, nothing should be taken for granted by the creditor. The burden of asking favors should be put on the debtor, especially when the creditor has done his part.

A collector can, on the one hand, be over-sanguine and easy and, on the other, too suspicious. He should always keep this question in mind: Is the account in jeopardy? If he thinks there is any danger, he should place the account in such condition that if anything happens it will be safeguarded. If a credit man grants a favor by extending time for payment on an account, he is privileged to ask for something in return; that is, he may ask for some surety or guarantee on the account. If such a proposition is tactfully put to a customer, it will generally win his assent. In such instance, it is always better to see a customer personally. What can be said can often not be written. The friendly expression of a man's face, the explanation of his attitude by word of mouth, an air of fairness and sympathy—things which

cannot easily be put into a letter—will place what may seem like a hard proposition in a good light. If a personal interview is not possible, it must, of course, be left to correspondence. The essential thing, then, is to leave no loopholes in a letter which will allow the debtor to prolong the matter. State your proposition and then put a clause on the end of it which will allow of no if's and and's. When a man feels such a tone in a letter, friendly, yet final, he will come to terms quickly.

LEGAL *action to collect should be avoided until peaceful methods have been exhausted—often it is better to compromise than to try to force payment.*

When peaceful methods have been exhausted, only one recourse remains—the law. Legal action is unpleasant and unfruitful, and the credit man should avoid it as long as possible. When he has decided that this is the only alternative, however, he should not quibble farther with the debtor, but carry out his intention.

For a concern with a large business, the best plan is that it have its own general attorney. He knows the house, is familiar with its business and policy; he is a part of it. He can handle a case in a way that a foreign attorney cannot; he will be much more determined to further the interests of the house, for he is working, not for himself, as is a foreign attorney, but for the house. He will also have a better knowledge of the case in question and of the customer himself, for as house attorney much work will come his way aside from the legal collections, which will make him familiar with customers. He can save his salary in commissions paid to a foreign attorney, and do much other work besides. Chronically slow cases, instead of being placed in the hands of a collection agency, can be placed in the hands of the

house attorney to be handled at his own discretion.

It is desirable the attorney use stationery of his own, such as will not make it generally known that he is house attorney, for an unfavorable impression may obtain among customers where it is known a legal department is required. It is preferable to call him an adjuster. In fact, if he is the right kind of a man, he will turn out to be much more of an adjuster than an attorney, and for this additional reason he will be of great value to a house.

A well organized collection department should be able to carry an account up to the point where it is turned over to the attorney for immediate suit. The services of a collection agency between the stage where the collection of the account becomes doubtful and the stage where it is placed in the hands of an attorney should not be necessary. The collection agencies are, however, a great help to a small house which has neither the time nor the organization to put the proper effect and expert services into collections.

As a general proposition, an honest debt is not open to compromise, but this is a statement which has a great many exceptions and is subject to many extenuating circumstances. If a debtor appears to have done his best and has made what is called an "honest failure," it cannot be other than the duty of the credit man to his firm to make the best settlement possible. In the case of a compromise, however, there should be a definite understanding with the other parties and with the debtor that all parties shall share alike. It is in just such matters that a credit man, if he is a good financier and a business man, will help to administer affairs of the debtor in such a way that he may be able to pull out of a bad hole. Generally speaking, compromises should be dis-

couraged. If investigation shows that the case is one of fraud or cowardice, rather than countenance such proceedings, creditors should combine to insure the full operation of the law.

WHO *is the best credit man? We cannot consider the credit man per se at all. We must consider him as the head of one of many departments of a business, and his department must work out that policy which is best adapted to the business as a whole and which will bring the best general results. An identical credit and collection policy for all lines of business and all houses would not do. The choice of the proper policy is really a matter requiring careful study, and depends on all the varied factors which go to make up a business and its environment. But whatever the nature of the business, that credit man is the best who will approve the largest percentage of orders and still keep his percentage of loss down to a fair average. One credit man might refuse half the orders which came to his house, while another would accept ninety per cent of them, and both show the same percentage of loss. The ninety per cent credit manager would certainly be the more valuable man of the two.*

—Peter R. Earling

Chairman, World's Congress on Credits and Collections

VII

CREDIT PROBLEMS OF THE MANUFACTURER

By Berthold E. Borges
of Ederheimer, Stein & Company

IN the management of manufacturing house credits and collections the problems involved and the methods used are much the same as those of a wholesale house, for the tendency is growing stronger for the manufacturer to deal directly with the retailer, and even the large consumer, without the intervention of the jobber. But even though we look upon the manufacturer as one who deals with the jobber, and the wholesaler as one who deals with the retailer direct, there would be very little difference in their methods of conducting credits, for the same care must be exercised in extending credit to a large, well-known jobber as to a small, unknown retailer. The only difference is that the jobber's account is many times as large as the retailer's and hence requires many times the care and often involves many times the worry that a smaller account does. The sources of information, the method of gathering it, and the consideration of it, are the same in the two cases.

It is in the attitude he takes, the object he has in view, his general policy, that the credit man of a manufacturing house differs widely from the credit man of a jobbing house. The manufacturer works nationally and even internationally, the jobber locally. The manufacturer hails with delight an order from a far corner of

the country; the jobber will look upon it with suspicion. The jobber has a particular territory in which he sells, which he tries to cover thoroughly, and he must sell to almost any one of any standing in his territory; the manufacturer need not sell indiscriminately, he merely takes the cream of the retail trade, the big retailers who stand head and shoulders above their competitors and whom it is to his advantage to have on his list of representatives. He can, in a way, choose his own customers, selecting the best, and still dealing with the poorer risks through a middleman. The credit man, by simply referring the latter to a jobber, can refuse credit without appearing to do so.

There is, however, another consideration which sometimes compels the manufacturer to assume an extraordinary risk. A jobber carries various lines of goods. He simply wishes to do a certain volume of business in a certain territory. If he can do this volume of business in eight cities of a territory in which there are twelve, he will let the other four go. A manufacturer is usually putting out an advertised line of goods, and he desires to be represented, broadly speaking, everywhere. He cannot afford to pass over one large commercial center, for having by his advertising created a demand, there is possibility of loss in failing to supply the demand and danger to his reputation by not offering facilities by which people can secure his goods. Thus, the credit man of a manufacturing house, in order that his goods may be on sale in a certain town or district, is often compelled to take more dangerous risks to accomplish this object than a jobber would ever take.

To demonstrate: A manufacturing house often has a new line of goods which it wishes to introduce. To do this, it must be willing to take extraordinary credit risks.

The manufacturing house is the pusher of the goods, and often places them merely for the advertising effect. It is never the purpose of a jobbing house to merely get goods before the public. Its purpose is always to sell a staple with the required margin of profit.

> INSURING *a systematic, even output of the factory by distributing credit over a wide territory is necessary in handling manufacturers' credits.*

A credit man of a manufacturing house must always keep a watchful eye on the stock, for in some lines of trade the goods left over at the end of the season are so much dead loss. One of his objects must be to distribute the sale of goods in such a way that at no time will the bulk of credit be in any one district, and that at no time will the bulk of sales be segregated in a particular period of the year and so conflict with a systematic, even output of the factory. This, again, is more the duty of the sales department, and yet the credit man can render marked aid. In most manufacturing business there are one or two seasons of the year when the consumers' demand is particularly heavy. The retailer will be most inclined to lay in a stock of goods just before these seasons begin. I need hardly to state that a factory whose output is evenly distributed over the twelve months of the year will have a much lower production cost per unit than if the output is crowded into one or two periods of three months each. Now, by making the terms of payment to the jobber and retailer longer, a credit man can secure orders several months before the consumer's demand begins. And if there be an understanding between the credit man and the sales department, by which the salesmen will secure such orders from the best customers of the house, the credit man can make his terms of payment

such that customers will suffer no disadvantage through early ordering.

In his direct relation with the sales department, the credit man should look upon it as he does upon the jobber. It is merely a selling agent, and must be watched in the same way as a jobber as to terms, discounts, and prices. The credit man must really act as a tail upon the over-zealous sales kite. He should be the watch dog of the treasury. Whether it confesses it or not, the object of the sales department is to sell as many goods as it can smuggle through the credit department, and the credit man must realize this.

But the most fatal thing for a business is lack of complete harmony, good understanding and cooperation between the credit and sales department. The credit man's object is, just as much as the sales department's, increase in the volume of the sales, but he adds the saving clause, "with the lowest percentage of loss and with the least expenditure of money." As will appear in the course of this discussion, the salesmen can be of much help to the credit man in his own work, and he cannot afford, under any consideration, to be on anything but the most friendly, harmonious and cooperative basis with them.

The relation of the credit man to the advertising department should also be close. He should always be broad enough to see that anything which conduces to advertising goods and to giving the public a good impression is worth while trying. He must often sell merely for the sake of being represented in a locality. Therefore he should be in close touch with the advertising department, in order to know what goods to push, and on what goods to take risks for the sake of publicity.

In the promotion which is done through correspond-

ence and other means from the home office, the credit man should have an influential part. There can be no profit in promoting business with a dangerous credit risk. The credit department should have in its hands the classification of the firms which the promoting department is trying to interest.

The knowledge which the credit man of a manufacturing house should have is of three distinct kinds. In the first place, he should have knowledge of business operations and a general understanding of financial conditions all over the country. Inasmuch as the business of a manufacturing house is national, the credit man should know the condition of the whole country and the commercial districts into which it divides itself. Very often one section of the country is undergoing an industrial depression, while another is enjoying boom times. He should be able to analyze such financial conditions and to apply them to the protection or furtherance of his business.

In the second place, a credit man should have a thorough understanding of the actual manufacturing and operative details of his own business. He should know the value of goods, the margin of profit and the stock on hand. He can afford to take a longer chance on goods which show a larger margin. He should be able to estimate the amount of an order without having to look up each item; if he were compelled to do this, his day would need to be three times as long as it is.

The very best man for any credit department is one who has grown up with the business. More than any other executive, the credit man should know the history, circumstances and possibilities of all its customers and accounts and the policy and purposes of his house. This he can only learn by long contact with them in the

bookkeeping and collection departments, and by an understanding, through experience, of the relation of the house to its customers.

> **B**ECAUSE *of the wide range of businesses with which the manufacturer deals the credit man must have a broad general knowledge of business conditions*

In the third place, a credit man should have some knowledge of the management and operation of any line of business in which his particular customers are engaged, even though the goods which his house sells may consist of the smallest part of the customers' stock. A manufacturing house may sell the hardware man, the general storekeeper, the business specializing in its one line only, the manufacturer, and direct to the customer. The credit man must gauge the credit to which a customer is entitled in proportion to the ratio which his goods bear to the whole business. That is, if a buyer's credit line is $10,000, and my goods will be only one-tenth of that stock, he is not entitled to more than $1,000 worth of credit from me, for very probably he will receive at least $9,000 worth from other sources. If each credit man were careful to limit the extension of credit to his proper proportion, there would never be that over-buying on the part of the retailer which is so often the forerunner of insolvency.

If the credit man has this knowledge, not only can he judge credits better, and can extract from the agency reports that come to him the exact condition of the customer's business, but when his relations with a customer have become intimate enough, he can act as an adviser.

Manufacturing terms are not always cash; often they are based on the requirements of the buyer. Each line of business has certain terms in trade all its own. These

terms are dictated by custom and are so well founded that rarely is there any question of term at all. Generally speaking, manufacturing houses in the same line grant the same terms.

But within each line distinctions are usually made between terms to jobbers, terms to retailers, and sales subject to special terms on contract. Briefly, the general principle is that the terms should be such as to allow the buyer to realize upon the goods bought before the bills for them fall due. Thus, suppose the season for a certain line of goods opens April 1 and closes about June 1. Goods shipped to jobbers as early as December 1, as often happens, will be billed to fall due on June 1. Now, the jobber will probably sell to the dealer on March 1 on ninety days' time. He gives ninety days in order that the dealer may not be forced to pay for goods until he himself has sold them. The retailer will get his payment from the consumer between April 1 and June 1. He will pay the jobber by June 1, and therefore the jobber will pay the manufacturer with the money that he has realized on the goods.

On a new line of goods which a manufacturing house is very desirous of placing on the market, even longer terms than these may be given, purely to attract orders.

To the retailer the manufacturer will naturally sell on shorter terms, inasmuch as he will sell to him at a later date than to the jobber, and hence not so long a time is necessary for the retailer to realize upon these goods.

Terms by one manufacturer to another who uses the goods of the first as raw material in manufacturing his product are usually the same as to a jobber. His orders are often filled on contract, and terms are then a matter of settlement between individual manufacturers.

Settlement by note, either with jobbers, retailers or

manufacturers, is much more usual with a manufacturing house than with any other concern. The clever credit man, however, can make the terms which the financial policy and condition of his house demands. If the house is working on small capital, the credit man, by giving discounts, will either be able to force shorter terms on his customer, or by taking notes may be able to get the use of the money. If he wishes to equalize his product, he can give long terms.

To make terms intelligently, a credit man should know if a customer has many of his accounts falling due at the same time. A certain account, for example, falls due on June 1. One of his well-informed creditors, knowing this, and having a similar maturing date for his line, knowing how difficult it will be for the customer to pay all his bills at this one date, and that he will probably require an extension, will equalize these payments; for instance, he will offer to allow the customer to pay one-third on May 15, one-third on June 1, and one-third on June 15. This proposition will probably look like a favor to the debtor, while it will be just as desirable for the creditor as to have the whole paid on June 1, and much better than to grant an extension on all of it.

IT IS *the abuse of credit, either intentional or through confidence unbacked by experience, that works havoc and lays a burden on innocent as well as guilty. In fact, had not the lesson been learned through hard experience, it might be more to the point to emphasize the necessity for being conservative in granting credit, than in dwelling on the methods to pursue in securing that element so vital to industrial growth.*

—Henry Clews
Founder, Henry Clews & Company

VIII

RETAIL CREDITS

By J. W. McConnell
Credit Manager, Carson, Pirie, Scott & Company

BETWEEN the credit activities of a retail house and those of a wholesale concern there is very little similarity. The two have wholly different policies; they deal with two radically different kinds of patronage; their attitude toward their customers differs as much as do the two classes of customers themselves; the information upon which they base their decisions is dissimilar; their methods of opening and handling outstanding accounts have little in common. Their objects are, perhaps, alike, but must be reached by different means.

The object which a retail credit man always has in view is an increase in sales with a minimum of losses. In other words, he wants to open as many accounts as possible, but open them on such a basis and watch them with such care that his percentage of losses will not be raised. The credit man should realize that his worth to the house he serves is directly in proportion to the volume of his open accounts. If his accounts run to the amount of one million dollars, he is earning just twice as much for the house as if they were five hundred thousand, always provided his percentage of losses does not increase. Although a bold statement, it is nevertheless true, that with competition as sharp as it is today, a retail house

may do well to encourage charge accounts. The cash customer flits from store to store; a house has no bond strong enough to hold him; a charge account affords this bond; the credit customer will buy where he has an account. It is part of the credit man's work to bind customers to the house.

Now, how is he to fulfill this important function? The mere extension of credit is not sufficient; it is not even a case of prices and quality—the sales department must work that end of it—it is much more a matter of treatment and service. The merchant buying from the wholesaler looks at but two things, the price and the quality; service may enter into the consideration, but even then only as regards promptness and accuracy. But in retail trade, service and treatment—the methods of handling and taking care of customers—are prime considerations. The retail customer is more of a human personality, and, as a rule, one of the "weaker sex," consequently less of a hard business machine than the wholesale buyer. She comes in closer, more personal contact with the business, she buys in person at the store, and often has personal interviews with the credit man or the heads of other departments. She requires more personal care than the merchant, she is less familiar with business operations, more sensitive concerning interrogations, and necessitates more careful handling.

RESPONSIBILITY *for keeping customers satisfied demands that the retail store credit man have a general oversight of the work of all the departments.*

Because the credit man must accomplish this vitally important task of keeping the customer satisfied, it is essential that his relations with other departments of the house be such as to command attention. He should ex-

ercise a general oversight over at least that part of the sales end of the business which affects the treatment of customers. This is a broad statement, and will extend his activities into the sales, the shipping, the complaint and the employment departments. To carry out his credit functions properly, he should be manager of the bookkeeping, cashier's and collection departments also. Their system must conform to the demands of his work, and, in order to watch his customers and their accounts properly, his touch with these departments must be so close that separation between them is impracticable, if not impossible.

Having these objects to accomplish, what are the qualities necessary for a successful store credit man? He should, above all things, be a man of great tact, diplomatic, capable of handling men, and more especially women. He comes in personal contact with a large number of people daily, men and women who cannot be handled in a technically business way because they know little of commercial affairs, and with such people it is much harder to do business than with the business man. Under the necessity of acquiring much of his information by personal contact with people, he should be able to draw them out so tactfully that he can get the information he wishes unawares. This also requires ability to read human nature, to judge of character and worth simply by his intuition; and intuition is merely acquired knowledge and experience intelligently applied.

That experience in the operative and selling branch of his business is of great value to a credit man cannot be denied. A credit man who knows the goods his house carries, their different grades and qualities, their values, their cost and selling price; who, through experience, is familiar with the buying of the goods, or with the

methods of selling; who can keep in touch with the methods of competitors in all lines—such a man naturally has an advantage, all other things being equal, over a credit man who has always been an office man.

As the wholesale credit man should, to some extent, inform himself concerning the general financial conditions of the country, so the credit man in the retail store should keep in touch with the local financial or commercial conditions, only his information, less extensive, must be much more minute and specific. If a large manufacturing house in his locality cuts down its force, if a body of men go on a strike, if a plant is about to move away from the city, he must know all the facts, for they are of value to him in making his decisions on credit extensions. The credit man, if he keeps his eyes and ears open, and is quick at putting two and two together, will learn and absorb many facts each day concerning his customers. The better he knows his community, and its people, the more quickly and intelligently will he be able to make his judgments, the less he will annoy his patrons, and the safer his decisions will be.

HONESTY, *integrity, worth and resources form the principal basis of retail credit—these facts are seldom obtained by inquiry into past history.*

The information upon which the credit man bases his judgment is such as will tell him the honesty and integrity of his customer, his worth and resources. His past history is of little value, except in so far as it relates to his credit record. The fact that a customer has gone through bankruptcy or was slow in making payments five years ago does not affect his retail credit if his present character is good; his whole business and social

record are not inquired into, nor his habits or associates. The retailer wants specific facts; the residence of the applicant, his position or source of income, the extent of his property, his present or past accounts, even such questions as the amount of his bank account, are considered legitimate. In case the applicant is a married woman, these questions, of course, refer to her husband.

This information is derived from the applicant himself, from outside sources, or both. Credit accounts are opened in one of two ways. Either the buyer makes direct application for credit, or he makes a purchase and simply requests the salesperson to have it charged. In either case the credit man bends his efforts to making his decision without recourse to personal interrogations. Such a course will bring trade, for it is simply one point in careful handling of customers. Women especially have such a terror of these interviews, that the possibility of passing through the ordeal will often deter them from attempting to open an account. They think that all their private history and personal secrets will be brutally exposed to the examination of a cold-blooded person who will delight in prying into their personal affairs. A house, therefore, which obtains a reputation for not requiring personal examination will draw these timid accounts. Such a course also flatters a customer, for it gives her the impression that she is so well and favorably known that she need present no credentials.

When a personal interview is absolutely necessary, the credit man attempts to make it as short and as impersonal as possible. He may obtain the information desired in a few direct questions. But if the applicant seems sensitive, he should endeavor to draw out the information he wants in an indirect way; to do this without seeming to pry unnecessarily into an applicant's pri-

vate affairs, and so hurting his sensibilities, is a delicate task. The credit man must often learn his facts in the course of a general conversation, by inference from statements and admissions, and from his own observation of the applicant. The facts thus obtained are usually verified from outside sources.

If the applicant is a business man he can be investigated through the medium of the mercantile agencies, as if he were buying an invoice of goods from a wholesale house, and all information necessary can be thus acquired. In case he is not engaged in mercantile pursuits, the commercial agencies are often able to afford the facts the credit man needs. If a man has even had any doubt cast upon his credit, if he has ever been sued, if an account of his has ever needed the services of a collection agency, if he has any old unpaid bills, or if his property is encumbered—all such facts they almost invariably have on record.

The retail stores of the large cities have no organized system of credit clearings or of reporting delinquent customers. The only time the store applies to another for information is when an applicant gives another store with which he has an account as a reference; then the latter store will give the information desired, more as a favor to its customer, to be sure, than to the house inquiring.

HOW *salesmen handle requests for credit from new customers; how the credit man obtains information on customers' responsibility; opening the account.*

When a buyer who has no account requests goods charged, since the clerk who approves all charge sales will not find him on his list, the sale will be passed up to the credit manager. He will attempt to pass on the

advisability of opening this account without a direct interview with the buyer, and will set in motion this machinery for investigation. The facts thus obtained are usually sufficient. Sometimes the buyer is so well known and of such undoubted integrity as to need no investigation at all. The account is opened and a polite note sent to the customer, assuring him that the opportunity of adding his name to the list of "charge customers" is appreciated.

Even though investigation in any case proves that the advisability of extending credit is a little doubtful, the retail credit man has a much wider field than his wholesale confrère for using his ingenuity in seeking a safe basis on which to open an account. Various means for securing and guaranteeing or limiting the account may be devised to suit individual cases.

Every account has a limit placed upon the monthly credit which is to be extended to the customer. This, however, is not a fixed line beyond which there is no advance; it is more a means of guiding the work of the employees of the credit department. It simply means that when a customer's purchases for any month have reached this limit, further sales must be submitted to the credit manager for approval. It is a kind of safety-valve by which an account is brought to the attention of the head of the credit department when it has reached a certain stage. The amount of the limit may be changed several times during the same month, depending on the condition of the customer's account and the kind of purchases he is making.

The real work of the credit man is not so much in opening accounts as in keeping in close touch with them after they are started and making prompt collections. The hold of the retail store on its charge customers is

far less tangible than that of the jobber. The merchant buying from the wholesale house has assets in his business; he must pay, or confess insolvency and lose his business reputation; he cannot move from one community to another with ease. No such considerations weigh with the retail buyer; the credit man must substitute for this, unceasing watchfulness over his account and his customers themselves.

In a large house it is absolutely necessary that he keep a record of his customers. The most convenient form is a card index arranged alphabetically, each card containing in concise form the salient facts and information regarding each customer. Any new information secured is at once entered on these cards, so that they are kept up to date.

The credit man's second source of information regarding his open accounts are his ledger records. With thousands of accounts on his books it is of course, impossible for the credit man to keep informed regarding the status of all his accounts. He must be satisfied if he can keep in touch with the more vital accounts—those which are overdue. This he can do most easily by looking over those of the statements sent out by the bookkeeping department on the first of each month which contain overdue items. In addition to this, the credit man should be notified the moment an account reaches the limit; the credit limit is placed at the top of the ledger sheet of each customer; the bookkeeper, as he enters the previous day's sales each morning, can make a memorandum of those accounts which have reached or overrun the limit, and place them on the credit man's desk.

In collections, again, the credit man must exercise tact and use his knowledge of his customers and their

affairs; and, knowing their peculiarities better than any one else in the house, he can best determine the general policy to be pursued in collections and the procedure in individual cases. Women, and many men also, take offense at even a reminder of indebtedness, classing all such as "duns." They must be treated very delicately, even though their accounts are overdue. It is at bottom a question of making them think that they are paying when they please, and yet so influencing them that their time of "paying when they please" will correspond with the time when the house wants them to pay. By the use of tactful reminders, the right kind of correspondence, and indirect methods, customers can be trained to be prompt payers. Some customers, perfectly good, pay only every sixty days or even quarterly. Their wishes must be observed, and one slip in the way of an insistent dun letter may lose the account. Credit men find that the financial arrangements of husband and wife differ greatly in different families. Some men do not wish any bills contracted by their wives to come to themselves or to their offices, but insist that they go directly to their wives; others do not want their wives to see any bills, but desire to have bills sent to themselves. Such wishes must be known and observed.

PROMPT *collections not only save losses in bad debts and decrease the amount of working capital necessary for running a business, but also increase sales.*

Sharp collections reduce the percentage of losses and the expense of running a business, and increase sales. As the age of a bill increases the chance of collecting it decreases; repeated attempts at collection often irritate a customer and make him even more prone to put off payment. The added expense comes in two ways; in

the time and money spent by the collectors and in correspondence; and, what is more vital, in the much greater amount of capital necessary for the carrying of overdue accounts. When a house has thousands of open accounts on its books, running into the hundreds of thousands in money, the saving in the interest on the capital tied up in bills receivable when they are collected ten days instead of sixty days after due, is no inconsiderable item.

A retail house has its corps of collectors like a wholesale house, but their method of work is wholly different. A man engaged in business expects statements and personal collectors when his account becomes overdue. The majority of debtors of a retail house consider a reiterated demand for payment as an affront, and a call from a collector as an insult. Nevertheless, the retail merchant must look after his collections even more sharply than a wholesaler, for only in this way can he make up for more or less risky extensions of credit.

That prompt collection increases sales results from the fact that a customer, having a large bill overdue at one store, will transfer his patronage to another establishment because of fear of being refused further credit at the first and a dislike of increasing his account.

All possible persuasion and peaceable efforts should be used in collecting before resorting to more strenuous methods. When an account reaches the stage, however, where it is apparent that the debtor is attempting to avoid his debt, and it becomes a question of getting payment in the quickest and surest way, legal steps should be taken. Before taking such steps the credit man must have made up his mind that it is to his interest to close the account in question. For, once he has taken recourse to law, he may as well make up his mind that the cus-

tomer is lost to him. It is bad policy for him to reopen an account with such a man, not only because he has proved himself untrustworthy and unprofitable, but also because, when a person is sued by a house, justly or unjustly, one can figure that he will be itching to put that house into a hole at the first opportunity.

The whole matter of collections, even more than that of making credits, depends upon a store's class of patrons. A high-grade, wealthy patronage needs an entirely different, much more subtle and less strenuous collection system than customers who belong to the less wealthy classes.

PERSONALITY *in business!" Those three words spell, to my mind, the most powerful factor in business today. Financial resource, of course, is necessary in the business field; foresight and the ability to grasp opportunities as they arise achieve much. But, it is only when these elements are combined with that peculiar characteristic of the individual which we call personality—that faculty of personal power, personal impression and personal understanding—that they attain the best and most permanent results.*

—George H. Barbour

Vice-President and General Manager, Michigan Stove Company

IX

INSTALMENT CREDITS

By E. F. Kennedy
President, The E. F. Kennedy Furniture Company

MERCHANTS who sell on the instalment basis have the advantage over the retailer in one way, in that they usually receive a cash down payment for part of the invoice and have a contract or mortgage of some kind for the remainder, which protect them against the loss of the goods, unless the customer is openly dishonest and fraudulent. On the other hand, the instalment dealer works at a disadvantage as compared with the retailer, for he virtually cannot discriminate as to whom he shall trust. And as instalment man, he must sell on this basis to all who offer themselves and can show any record at all. If he refuses them, he not only loses this order, but very likely the entire trade of the customer. The retailer, if he does not think it advisable to extend credit, can often persuade the applicant to pay cash, and thus keep his patronage. The retailer can put off granting credit for months until he has traded with the customer and knows his trustworthiness from personal experience, without giving serious offense or necessarily losing a sale or a customer. If an instalment merchant refuses credit, there is no other alternative open—the sale, and probably the customer, is lost.

In granting credit to a new customer, the credit man of an instalment house must depend almost entirely on

his intuitions and experience in judging men. He has three classes to face; those who are honest and intend to pay, and who will pay; those who are honest and of good intentions, but who overestimate their ability to pay and eventually will fail to pay; and those who never intend to pay and are simply trying to obtain the goods under false pretenses.

The latter class is very small. Such strong guards have been placed around the instalment contract that fraud is difficult and dangerous. The great majority of buyers are of good intentions, and a credit man can make no bigger mistake than to go on the assumption that all people are dishonest dead beats, and that his business is to keep the house from being cheated. This suspicious and pessimistic attitude will hurt his work and the trade of his house rather than help it. There is no man or woman so proud and sensitive as the "poor but honest," and it is largely with this class of people that the instalment house deals.

QUICK *decisions are required of the instalment credit man—a few minutes' conversation with the prospective buyer must determine the value of the risk.*

The credit man, having the bill of goods ordered and the buyer himself before him, must decide almost on the spot, from his impressions of the individual and the information he obtains from his direct questioning, whether to approve the sale and allow the credit. The instalment house is not now, as formerly, in the position of one granting favors, and so permitted to ask any questions, to dictate any terms, and generally tread all over the sensibilities of the buyer. There is now too much competition in this line of business. Buying on instalments no longer reflects any discredit on the buyer as it

once did; he is quite as likely as not to have money invested or in a savings account which he does not wish to draw upon. He has a choice between houses, and he usually bases his selection on their methods of inquiry and their terms; he has consequently become more independent and sensitive, and he must be treated accordingly.

The credit man must, of course, secure certain information relative to a customer's stability and circumstances, preliminary to approving a sale. The greater part of this information he must get directly from the customer himself. And just because this customer will be sensitive, the credit man should learn as much as possible by indirect questioning in the course of a pleasant, rambling conversation; he must lead up to unconscious admissions and side-remarks and implications. The usual information desired is: the reason the customer is buying on instalments; the source of his income, from which the instalments are to be paid; where the person, husband, father, or whoever is responsible for the payments, works; the general circumstances of the customer as to property owned, bank account, and so on.

If the credit man starts on his search for this information from an attitude of suspicion, he is bound to antagonize the customer. He must rather appear sympathetic, obliging, as if all were a mere formality and unnecessary for the extension of credit in this case. Pleasantness, an appearance and tone of friendliness, a sincere and apparent desire to be helpful and accommodating, go a long way in any kind of business activity, but nowhere are they more to be emphasized than here.

The credit man must virtually make his decisions on the spur of the moment, judging of the truth of the facts given him from general appearances and his in-

tangible impressions. He can, and very often does, investigate the facts he has obtained before the goods are delivered, but the most he can do is to find out whether the place of employment given is correct, and even this he must do secretly, for the information is usually given confidentially. A customer usually does not wish his employer or any one else to know that he is buying in this manner, and consequently verification of the facts he gives cannot be made openly. In this respect the wishes of the customers must be observed if his account is to be kept by the house. The credit man must judge of the customer's honesty from his general appearance and attitude; he must determine whether the different items of information he gives agree, and whether the goods bought, both as to the size of the order and the quality of the goods, seem to be in accord with the apparent circumstances of the customer.

The credit man should always be on the lookout for "dead beats." They are either very hard or very easy to recognize, for either they are clumsy and can be detected at first sight from their appearance or from the apparent invention of the information they give, or they are very clever and put up an almost undetectable front. The only way to cope with the latter is to make the contract of sale so binding, and the follow-up and collection system so stringent, that they cannot get an opportunity to carry out their fraudulent designs.

The hardest task of the credit man is to detect such among the honest and good-intentioned people as are evidently over-reaching their resources in their purchases. To discover such people requires deep insight into character and a clever analysis of the information under review. Long experience with instalment sales and accounts will enable the credit man to estimate with re-

markable accuracy the approximate paying value of a given income or certain resources. Even when he has detected such a person, however, a task equally hard is to handle the customer in such a way as to make a sale and still be safe. If his judgment places a prospective buyer in this class, the credit man probably will not wish to "turn him down"; he may come to be a good customer. The credit man must seek to bring the order to a safe basis.

COLLECTIONS *are the vital part of a credit man's duties—in no other line of business is close supervision of this phase of credit work so important.*

The collection department of any business house should be closely allied to the credit department, but in no business is this so necessary, and in fact indispensable, as in an instalment house. A vigilant, sharp, intelligent collection policy and system will do much more to reduce the percentage of foreclosures and bad accounts than the best credit making, for not only can a good collection department save a doubtful account, but a poor one can lose many good bills.

Even more important than this is the fact that prompt collections increase the volume of sales. A credit man who knows his collections are being well taken care of can make his terms a little more liberal, and can thus accept more orders and will in the end draw more trade. Then, too, a customer who gets his account paid up promptly will come back for a new purchase sooner and he will be more apt to come back anyway, for prompt payments are the easiest to make and cause the least trouble and friction between house and customer.

Each account should be carefully watched, not a day's delay in payment allowed without the reason being

known, and the circumstances and movements of customers zealously followed. It is the regular, permanent customer who brings the profit, and the regular customer is the one with whom the house never has the least trouble; customers can be trained to pay promptly as they can be encouraged to be dilatory. The longer a payment is put off, the heavier the burden becomes. The point, that the older a bill is the harder it is to collect, is especially well taken in case of instalment accounts, for delay on one payment is going to throw all those that follow out of gear and make their collection just so much more difficult.

Foreclosures should be a last resort. Under no circumstances does it pay to force a seizure of the goods sold when there is the least possibility of peaceable settlement. It is much better to extend the mortgage, grant more time, coax the customer along as far as possible. Foreclosing invariably results in the loss of the customer, is liable to give the house a bad reputation, whether justly or unjustly, and is never profitable. The goods returned are always worn and must be resold at second-hand prices. The credit and collection department may have "no profit on account" chalked up against it, but any number of these show better management than a row of foreclosures.

LET *your customer know that a personal interest attaches to him—a real personal interest that is not measured wholly by his orders and his dollars—and you will win in return that close personal association and active support that builds up business.*

—George H. Barbour

Vice-President and General Manager, Michigan Stove Company

X

CREDITS AND COLLECTIONS IN FOREIGN TRADE

By John E. Gardin
First Vice-President and Manager, Foreign Exchange Department, National City Bank of New York

AMERICAN merchants who seek a market for their wares in foreign countries are confronted with the fact that they know very little about their customers, nor do they know, as a rule, anything about the customs prevailing in the commercial centers abroad. This lack of knowledge not only leads to monetary loss, but also to loss of prestige in consequence of the matter not being handled according to his customer's views, thus piling up difficulties at the outset of his career as a factor in foreign markets. Chauvinism is rampant in all countries, and the foreigner entertains the same view as the American does in a great many respects, that there is nothing good to come from any country but his own.

It is only by dint of the hardest kind of work, the untiring efforts of our consular officers abroad and the ceaseless energy of the pioneers in this country in foreign trade, that America has been at last able to bring before the public in foreign lands the excellence of its goods. To what extent American products are in demand on the other side of the water has been fully demonstrated. The fame of the American producer is now well established, and the great corporations who are seeking an outlet for their surplus wares have no diffi-

culty in selling as much of their product as they desire, and the only question is that of price.

However, this was not accomplished without the greatest labor on the part of such corporations through the organization of agencies in all the principal cities of Europe and elsewhere, by the organization even of banks to handle the financial end of their business. The result is that their sales abroad now run into hundreds of millions of dollars annually.

MERCHANTS *engaged in foreign trade without means to establish an organization to protect their interests are dependent on banks for assistance.*

The ordinary merchant, in the first place, has not the means at his command to perfect an organization which will protect his interests at every stage of the sale, but must depend upon his own individual efforts, aided by integrity and honesty, in dealing with his clients. In this respect he is ably assisted by the various banking institutions of importance in this country, all of which have large and extended foreign connections.

Advantage is taken frequently by unscrupulous concerns abroad to work schemes upon the American mercantile community, and these are often successful. Particularly in Holland there is a well organized clique of swindlers, who, on the basis of advertisements in trade journals, send in orders for goods and, upon receiving them, disappear from the scene altogether, only to reappear under a different name perhaps in a different city. This gang has for a number of years successfully exploited American exporters. The same thing is going on in other countries, but not to the same extent. It therefore behooves the American exporter to have great care whom he is dealing with; and he can do so, for he

has abundant opportunity before shipping goods to inform himself in regard to the solvency of any would-be clients.

England has an exceedingly elaborate and reliable system of commercial reports in the well tabulated returns of the commercial agency of Seyd's, commonly known as Seyd's Reports. In these reports every commercial house of any standing whatever is quoted in four different columns, giving trade extent, monetary credit and other information which serves as a guide to the exporter. These reports are the most reliable of any published in any country, our own not excepted. Seyd's Reports alone constitute a library, and while they are expensive, to a large commercial house doing an important business with England they are an absolute necessity. The small merchant need not go to this expense for gaining the benefit of this elaborate system, as every banking institution of any importance doing a foreign business has this work in its library, and they are always willing to allow the use of it to their clients.

In addition to these reports, every large banking institution has files of information concerning the standing of practically every important business house in the world, and the benefit of years of labor in this respect is placed at the disposal of business men at the expense of perhaps a two-cent postage stamp. Should, contrary to expectation, the files be incomplete to the extent of just the one party that is inquired about, this deficiency can be remedied instantaneously at a slight cost and delay by making inquiry through its connections abroad as to the standing of the party desired. In the event of an important deal this inquiry can be made by cable, so that the reply would be to hand within a few hours.

The most reliable information concerning foreign

parties, of course, is to be obtained only through foreign bankers. But the foreign banker declines, and with good reason, to impart any information concerning commercial houses in his locality to any but banks and bankers with whom he is in connection. Therefore, the merchant who desires information should apply to his bank, which, in its turn, will send the matter on to its proper destination, so that an answer will be forthcoming as fast as the mail or telegraph can bring it.

My advice, therefore, is: Do not hesitate to call upon your banker. He is at all times ready to aid commerce in all its branches and does so most efficiently. Any reason to the effect that doing this service brings no returns to him is a fallacious one. It is true it brings no immediate returns; quite to the contrary, it costs him money, in the time of his employees, in postage, and so on. But the advantage is a collateral one to the extent that it furthers the business, and if the information is satisfactory and leads to engagements, the banker sooner or later is sure to get his share. Procuring information for his friends is simply casting bread upon the waters. The returns will surely come some time or another. Consequently the merchant need not hesitate to employ his bankers with perfect freedom, and may rest assured that the service is not grudgingly rendered.

INFORMATION *concerning inquiries obtained through foreign credit agencies should be supplemented and verified by information obtained from other sources.*

On the continent there are well-established bureaus which impart what credit information is obtainable for a certain fee, which as a rule is rather a small one; still these reports, as a general thing, are reliable and are an indication as to whether the party with whom the mer-

chant in this country intends doing business is reputable or not. Nevertheless, the information from the banker, as a supplementary matter, is absolutely essential, inasmuch as the private institution very reluctantly or in fact rarely ever gives information that is bad, owing to the stringent libel laws in foreign lands.

Quite frequently the argument is advanced: "What do I care what the standing of the parties abroad is? I can arrange matters in such a way that they cannot get hold of the goods without paying my bill." While this is true in a great many cases, still it is a risky way of doing business. The merchant forwards his goods, perhaps consigned to his own order, attaches his bills of lading, insurance certificate and other documents that are required to a draft which is made upon the purchaser and deposits this with his banker, secure in the feeling that his goods will not be delivered to the purchaser unless the quid pro quo is duly returned. Should it turn out that the buyer is not reliable and the goods are withheld, the expense of taking care of the merchandise on arrival, the vexatious delays and annoyances and the sacrifice that he will have to submit to in disposing of the goods, unless he desires to throw good money after the bad in having the goods returned, will eat up his profits. It is easier to investigate the reliability of the customer before filling the order.

Granted now that information shows a foreign buyer to be reliable and satisfactory, what methods are open to the credit man for making his collections? Three courses are open to him: Draft on the buyer with shipping documents attached; draft on a bank in which the buyer has a deposit or credit, and a "clean" draft.

The first method is the most common, and is the safest, considering its simplicity. When goods are shipped to

the buyer in a foreign country, the bill of lading and other shipping documents which he requires before the goods can be delivered to him by the transportation company are attached to a draft. These shipping documents consist of bills of lading, and insurance certificates, in the case of ordinary manufactured goods; documents such as inspection certificates, are required where cereals are shipped; in shipments of meat products, inspection certificates, generally of two kinds, are required—board of trade certificates of inspection, and United States government microscopical certificates; in shipments to some countries where a differential tariff is in vogue, certificates of origin are required.

DIFFERENT *methods open to the shipper in foreign trade for making collections—the method of drawing drafts on buyers and attaching the shipping documents.*

The seller sells this draft with document attached to his local bank, and is paid for it by check or by a credit to his account. The bank takes no risk, for, even though the buyer does not pay, it has possession of the goods, and can even hold the seller for the amount. The banker forwards the draft to his correspondent abroad in the locality of the buyer for collection. The buyer cannot obtain the goods until he honors the draft.

Usually the goods are sold on time, the drafts running for sixty or ninety days. To enable the purchaser to obtain possession of the goods in the event of a sale, or if they are of a perishable nature, prior to the maturity of the draft, a provision is made to the effect that should it be desired, the purchaser can withdraw the goods upon payment of the draft under a rebate of interest at a certain percentage—on the continent generally at the official rate of discount of the state bank of the country.

Even with this seemingly safe method, the shipper should exercise every precaution, for it does not always protect him. The goods themselves should never bear any marks or address by which the consignee could in any way prove they were intended for him, and thus claim them in the absence of the bill of lading, as frequently happens when the merchandise arrives at destination before the draft is presented. The transportation company's agent is almost always under the influence of local merchants, and his standing in the community in a great measure depends upon their good will; hence, when it comes to favoring any one where there is the slightest ambiguity in the shipping instructions, it certainly will not be the foreign shipper. If the packages of goods have to be marked, it should be with the name or initials of the shipper, and the bills of lading themselves should always read that the goods are delivered only to the order of the shipper. These remarks apply chiefly to remote points, as the principal European countries are subject to well-established rules and regulations; but notwithstanding this, considerable laxity exists, and it behooves a shipper to be as technical as possible, as it is always on technical grounds that the agents of transportation companies claim immunity.

The second method of obtaining payment for goods is used when the consignee is not known to the shipper and the latter does not wish to take the risk of the expense of having the goods returned to him in case draft is not honored. The buyer then makes a deposit with some foreign bank, or, if he is favorably known, gets a credit for a certain length of time. The bank writes to the seller—and often also to the seller's bank—stating that the seller can draw on the buyer at this bank for a certain length of time up to a specified amount, with proper

documents, showing that goods have been shipped, attached to the draft. The seller presents this letter to his bank, which takes up his draft with papers attached and makes collection from the foreign bank. In this case the whole risk lies with the foreign bank.

This method is generally used in trade with South America and countries having poor banking facilities and poorer credit. Deposits are usually made or credit obtained by the buyer in a London bank through which drafts can most easily and safely be drawn.

Making a "clean" draft on a customer is the third method open to the seller. This is identical with drawing sight draft on a domestic debtor. The goods are shipped to the address of the buyer without attachments. When the bill falls due, the seller draws on the buyer for the amount of the shipment through his local bank, which in turn collects through its foreign correspondent. In this case the seller bears all the risk. It is used only in selling to accredited foreign agents or to houses whose credit is beyond suspicion.

The credit man cannot conduct his foreign trade in the way that he handles his domestic business. He must, in the first place, exercise the utmost care in the details. He must handle his trade with each country differently, according to its laws and customs and its banking facilities and standards of commercial integrity.

MEMORY *will often carry for years the general impression of "good" or "bad" in connection with a name, even though that name in the meantime has never been brought to mind. But it is unsafe to depend on memory beyond that point, for many of the "good" are good only under certain conditions, and very few are good regardless of conditions.*

—Dorchester Mapes.

PART III—DETAILED CREDIT AND COLLECTION SYSTEMS

The Credit Man

CREDIT is based upon confidence. When credit is extended it must be upon a belief that the recipient will pay when the account is due.

The credit man must, therefore, seek constantly for reasons upon which to base this confidence: for "the strength of the credit man is knowledge." He must be constantly alert with all his faculties at concert pitch, as careful and watchful as the paying teller of a bank: for, in passing credits, he is merely paying out merchandise instead of currency.

In compiling information he must have a thorough system for arranging and analyzing the facts obtained but, *more important*, he must become skilled and expert in drawing correct conclusions and inferences from his knowledge of these facts.

The credit man can learn in various ways the chief causes of failures. The path of safety lies in extending credit only when these *causes* are not in evidence and where the opposite conditions maintain.

F. H. McADOW

Secretary, Staver Carriage Company

Ex-President, The National Credit Men's Association

XI

HOW A WHOLESALE HOUSE HANDLES ITS ACCOUNTS

By E. F. French
Credit Manager, J. V. Farwell & Company

SEVERAL decades of business building have resulted in the system which is outlined in this article. It is not the production of one man, but the result of the work of many, and has been modified by various business conditions.

One important feature of this system is that all orders do not necessarily pass the inspection of the credit department. The principle observed is that, since seventy-five per cent of desirable merchants discount all purchases, and are perfectly good for lines of credit commensurate with the amount of capital employed in their business, it is unnecessary for these accounts to be watched carefully by the credit office, but only accounts concerning which there is the least doubt, or upon which there is the least stain, require the observing eye of the credit manager upon them. This does not mean that all accounts should not be periodically reviewed and revised by the credit man, nor do the words "doubtful" or "stain" refer only to large factors, but to the slightest deviations from the straight and narrow path of business integrity. By eliminating in a measure such desirable, discounting accounts, the credit department is not only saved a great deal of work, but is given time to observe closely the accounts which need watching.

All mail for the house is received and opened in the cashier's department; only remittance letters and money, however, are retained in this department. The balance of the mail, including orders, is immediately sent to the credit department, where it is separated. The orders, being the most important feature, are promptly distributed by clerks to the bookkeeper's department, where they are separated by the various bookkeepers according to the desirability of the customer. The orders from those whose accounts are in good condition and who have liberal lines of credit (according to characters noted on each account) are turned over to the salesmen, after having the time received stamped upon them, without going to the credit office. Upon all doubtful and new accounts there is a slip showing the condition of the account and line of credit. These orders only are referred to the credit office.

PROMPTNESS *is required in handling orders from new customers; a complete and detailed system in actual operation for handling new credit accounts.*

There should be as little delay as possible in filling new orders. Promptness in executing the first order disposes the merchant to repeat his orders, thereby increasing the account. A large percentage of orders can be turned over to the sales department, upon the high rating of the merchant in the various mercantile agency books, while the usual investigation can be made later. If, however, the book rating is in the least unsatisfactory, the order is retained until special reports are obtained, and if such information is in the least conflicting or unfavorable the order is still kept until all references and replies to inquiries from correspondents are received.

If the volume of information is not altogether satisfactory, the customer is written direct for a statement of his financial affairs, a guarantee covering his purchases, or a remittance covering the amount of the order. Inasmuch as a large percentage of orders are now taken by traveling salesmen, several months prior to date of shipment, and, if from a new customer, are accompanied with report blanks giving the customer's references as well as the salesman's impressions, the credit department has ample time in which to make the investigation before the date of shipment. But in order that no mistakes may be made on account of filling orders which will not be shipped promptly, a memorandum of the estimated amount of all orders for future shipment is sent to the credit department just prior to the filling of such orders. In this way the house will not be put to the expense of filling the order unless the goods are to be shipped.

When a new account has been passed upon and approved, a special sheet is made for it by the stenographer (this house uses the loose-leaf ledger system) and upon this sheet is inserted, in characters, the classification and line of credit, as well as terms and name of the general salesman. The classification indicates the desirability of the account. For the benefit of the traveling salesman, this classification is inserted in the road salesman's credit guide, which will be hereafter mentioned. The line of credit is the amount of credit given by the credit manager, based upon information he has received, the character and general condition of the customer, how much confidence can be placed in him, and so on. If a customer's business is in a good healthy condition and if, for instance, he has a capital of $10,000, all in his business, he is entitled to a given line of credit, although it is often increased, according to the extent to which he

confines his purchases to the company, and the promptness with which he meets his obligations. This increased line is usually determined by the amount of business he is doing, and similar considerations. A customer with a stock of $10,000, and doing a business of $30,000, is entitled to a larger line of credit than a customer with the same amount of capital and doing a business of only $15,000 to $20,000. Statistics show that if in this line of business a merchant does not turn his stock at least twice annually, he is not making any money.

Using the original ledgers instead of collection books is preferable, in that the condition of the customer's account may be quickly noted, together with payments, so that the amount past due may be treated accordingly; in fact, payments, slow or prompt, are the best indicators of a customer's condition. Every ten days the credit manager receives from the bookkeeper all ledgers, with slips projecting where there is an amount past due. This keeps the credit man in the closest touch with his customers and gives him a knowledge of their condition which cannot be obtained in any other way. It is often said in credit circles that a strenuous collection department obviates the necessity for a particularly able credit department. It can be just as positively asserted that an able credit department avoids the necessity for an extremely capable collection department. It is to the latter idea that this system leans, although collections are by no means neglected.

Now let us take up an order from an old customer, which has been received by the bookkeeping department. In the first place, the bookkeeper refers to the ledger. If there is nothing past due and the indebtedness is within the line of credit noted in the ledger, the order

is immediately sent to the general salesman to be filled. After it is filled, however, and ready for shipment, a shipping ticket is sent to the credit department for its O. K. In this way, no order really goes out of the house without coming under the eyes of the credit manager. In case an order is received from a customer whose account is not in a satisfactory condition or whose rating is below the rank which entitles him to be called good, or which is too large for the bookkeeping department to pass upon on its own responsibility, then a ticket is attached by the bookkeeper, upon which is noted the condition of the account, last payment, line of credit, and so on, in order that the credit manager may decide promptly as to whether or not the order shall be filled. The order is then referred to the credit manager for approval. Often, in cases of this kind, new information and a new financial statement are necessary.

HOW *periodic revisions of customers' credit ratings are made; filing the customers' reports; how travelers' credit guides save time and expense.*

A revision of credit lines on all customers is made periodically and the lines are raised or lowered, according to changes of the customer's commercial rating and his promptness in meeting his obligations.

All credit information is filed in separate envelopes, on which is written a brief synopsis of the customer's condition, line of credit and other general information, to avoid the necessity of the credit man going through the entire mass of information.

Each of the traveling salesmen for this company is furnished with a traveler's credit guide. This has been found indispensable, for it not only saves an enormous annual expense to the company, but the time of the

traveling salesman. This guide keeps each salesman thoroughly posted as to the credit condition of all merchants he anticipates visiting and in this book the classifications noted in the ledger are inserted. These classifications fluctuate according to the desirability of the account, based on responsibility and payments.

In case of the inability of the credit department to collect an amount past due, after mailing statements, writing letters and making drafts, or where a merchant is in financial difficulty, the account is transferred to what is termed the "docket ledger" (also the loose-leaf ledger system) and a sheet made, upon which is inserted the reason why the account is placed on the docket as well as a synopsis of all correspondence after the transfer is made. This docket is carefully watched by the company's attorney and his assistant.

The essential points in this system are: Full and satisfactory initial information, frequent revision of information, closest watch on doubtful customers and overdue accounts, prompt and strict collections, economy of time in the credit department, and avoidance of delay in filling and shipping orders.

SLOW PAYERS" *are especially troublesome. The credit man may know them to be perfectly good and safe, but because of carelessness or because they are chronically slow, they are forever letting their bills get overdue. The credit man must work with these men personally, educating and training them to proper business methods even to the extent of coercion and threats when friendly methods fail.*

—Harlow N. Higinbotham

President, The National Grocer Company
Formerly Credit Manager, Marshall Field and Company

XII

HOW A MANUFACTURER HANDLES HIS ACCOUNTS

By Alfred Terrell
Secretary, The Simmons Manufacturing Company

LACK of judgment and carelessness are the two chief causes of a high percentage of losses from bad debts in a firm's accounts. From this it follows that the requisites of a good credit system are: first, the prevention of poor judgments by bringing before the credit man, to aid him in his determination of credit extension, the fullest possible information regarding applicants; and, second, the eradication of carelessness by keeping before the credit man at all times the details regarding customers' accounts, and by warning him automatically when an account becomes dangerous or a customer doubtful.

The point has been emphasized that the credit man should not be so overwhelmed with petty work that no time is left him for thought and study; his system, therefore, should take care of the routine and attend to the details of the credit department mechanically without requiring his attention, leaving his mind free for the weightier affairs of his position. The system should delay orders as little as possible in their passage through the credit department, and information or records necessary for the determination of an extension of credit should be at hand.

The system here described is in practical operation in

a manufacturing house, which, like most establishments of its kind to-day, sells both to jobbers and retailers, so that it is equally applicable to either a manufacturing or wholesale business. The house which uses it shows a percentage of loss of seventy-three thousandths of one per cent on the total amount of business done—considerably less than one-tenth of one per cent.

HOW *orders from customers come up to the credit department—the advantage to the credit man of keeping in touch with the customers' general correspondence.*

All the mail entering the house is opened by a mailing clerk. This clerk marks on the letter the index number of its writer. Each correspondent of the house and each firm or individual who does any business with it is given an index number, which is consecutive, one series for each state. Thus, the number of John Jones, who lives in Peoria, will be Illinois 126; that of Will Brown, who lives in Des Moines, is Iowa 489. This number is used in all the filing done. The correspondence is filed numerically under the states by these numbers; they are used as the numbers of the ledger accounts of the customers; orders are filed according to them; mercantile and other reports are classified likewise. An alphabetical index of all customers is kept, so that, when a man's name but not his number is known, the latter can immediately be found. Everything else is filed according to his number.

The letters given their proper number by the mailing clerk, all the correspondence passes to the credit man for distribution. Why to him instead of, as is the usual custom, to the secretary of the firm or to some clerk? Because the credit man, more than any other responsible head of the house, must keep in touch with the affairs

of the house. He can thus keep absolute track of collections when they come in, without having to get a report from the bookkeeping department every day; he can see who is taking advantage of discounts, and the drafts which are returned—a very important fact for the credit man's store of knowledge; he can keep in touch with the sales and the other departments without any special work or reports; the things he can pick up in the general correspondence—inquiries, complaints, objections to certain prices and charges—afford a more enlightening source for general opinion of a customer's

RATINGS	NAME	NO.
	ADDRESS	

EXPLANATORY	DATE	DESC'TIVE	TERMS	E.N.	CHARGES	D.G.	CREDITS

FORM I: The ledger card. The distinctive feature of this card is the space for a note giving the credit man at a glance an idea of the character and condition of the customer

attitude and desirability than is usually appreciated. In short, the credit man can thus keep his finger on the pulse of the business; can notice every little change; can feel every movement, the vital, the vibrating actuality.

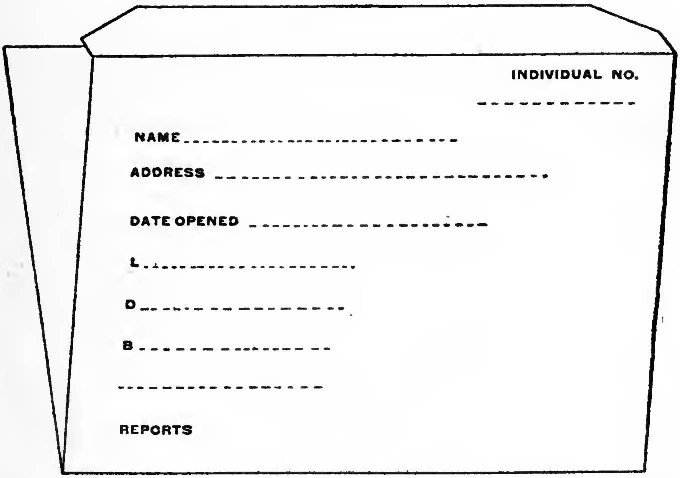
The credit man does not classify the mail first, distribute it, and then go back to pass judgment on his orders. He does his own work as he goes along. It may seem that this would retard the course of the mail and keep it too long from its ultimate destination in the office. But the system prevents this. In the great majority of cases the credit man need but glance at an order to determine whether he can let it pass; his constant contact with remittances and general correspondence through his handling the mail just described, his relation to the collection department, and his periodical revision of all his information regarding customers, to be described later, bring to his mind the instant he sees a customer's name the condition of his account. He need not know all the details of the special report which he may have received from one or more of the agencies; all he needs to remember is: Did I determine that this man was good when I studied his report? What is the present condition of his account? Does he owe anything? Are any of his bills overdue? And is this the usual size of his order?

If he knows these facts, and they are favorable, he is safe in granting the credit desired in the order. If he is in the least doubt as to his customer's account, that is, if he is not sure of this information, or if the customer's account, as he remembers it, is not in good condition, let him wait. Hoyle's famous rule may be paraphrased for the credit man to read: "When in doubt, get more information."

But how, the question comes, can the system make a man obey this rule? How can the system influence a credit man to wait and get more information? Is not that a matter of judgment or of will? The system helps and trains him to wait, because it makes the acquisition

of more information easy, almost automatic. When the credit man feels doubt or suspicion regarding any account, he lays the order to one side. An office boy, knowing that orders lying in that place are to have the accounts of their senders investigated, takes the letter or order, finds on it the index number, goes to the ledger file—the card system of ledgers is used with this system —picks out the proper card and brings it to the credit man.

When the credit man has finished distributing the correspondence, this little pile of orders with the ledger



FORM II: The folder in which all reports and information concerning customers are filed. When orders are received from a new customer this folder is sent with the order to the credit man

cards is ready for his consideration. The necessity for the credit department being the head of the whole office department, and so in control of the policy and methods of the bookkeeping department as well as of its more

immediate department, is here evidenced. Were the old bound book ledgers used, this system would be well nigh impossible, wholly impossible in a large business where the ledgers must be in constant use in the bookkeeping department. But the taking out of a card here and there by the credit man for his use does not discommode the bookkeeping department's work, and the account wanted can be placed directly before the credit man and handled by him with infinitely more ease and dispatch.

On this ledger card are the usual debit and credit entries, enabling the credit man to see at once the condition of the customer's account, terms on which goods are sold him, and his rating. But the distinctive thing about this card is a brief, written on a space provided on the most conspicuous part of the card, of the character and condition of the man, as abstracted from the various reports and other sources of information gathered regarding him. This brief contains the meat of the mercantile, attorney and personal reports; it is revised constantly as new information comes in, and obviates any reference to the long drawn out and rehashed mercantile reports. This card will tell the credit man at a glance whether the customer is worthy of further credit.

These briefs are compiled by the credit man himself. When a report is received on a new customer, a brief is made out and written on a small card. This is placed, together with the report itself, in a folder, upon which is entered the name, the index number and the rating and reports of the customer. It is then passed on to the bookkeeping department, where a ledger card is made out for this man and the brief copied on it. The folder with the card and reports is filed in a report case in its numerical order. As new reports and information come in, the brief is revised.

It might seem convenient for the credit man to have these small card briefs filed in a little case on his desk instead of with the reports themselves, so that he could refer to them quickly without having to go to the ledger card. But this is the very thing which would encourage carelessness. Not having on this card the statement and history of the customer's account with the house, at least equal to the brief in importance, the credit man would be tempted to jump at his conclusions, having only half the needed information at hand, and guessing at the rest. And guessing, in a credit department, is no less than criminal.

METHODS *used in passing judgment on doubtful orders—a complete plan for securing the greatest degree of speed and accuracy in handling this work.*

In going through his orders, however, the credit man may come across one whose determination demands that he have more information regarding the customer than merely the brief on the ledger. This order he then throws into a designated pigeonhole and his clerk, knowing that the folder containing the full reports and information on this man are wanted, in addition to the ledger card, will get both and lay them before the credit man. Further than this, the credit man may desire an entirely new report on a customer. He then takes the folder, such as is shown in Form II, marking under "Reports" from what agency or what sources he desires the report to be obtained. The clerk will immediately take this and send to the proper place for reports. All orders which are being thus held for information are placed together and the credit man goes through them every day, so that none will be overlooked and delayed any longer than is necessary.

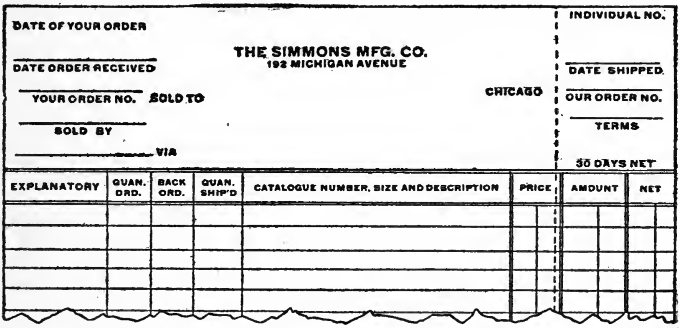
A credit man will often be sufficiently secure regarding an account to send out the order, and still think it advisable to get further information in order to be forearmed. In this case he passes the order through, but marks on a folder as before the report wanted, and the clerk goes through the same process as for the preceding case. Instead of putting these folders with the pile requiring daily attention, they are placed in another pigeonhole to await the information sought.

This latter process applies especially to first orders from new customers. The clerk who opens the mail can recognize the first order, since the man sending it will have no index number. Such orders do not go with the general mail to the credit man's desk, but go immediately to his clerk, who makes out for the new order index and ledger cards and a report folder, writing on the cover not only the name and address of the new customer, but also the rating given by the mercantile agencies, which he immediately looks up. These folders then come to the credit man. Very often he decides from the ratings that he can venture sending the order at once, taking his leisure to look up the new man or firm in detail. This he will do only when the ratings are good and identical, a very significant consideration, for if the ratings are not the same, not only is one bound to be more unfavorable than the other, but it shows that the agency having the poorer rating has some information that is of prime importance to the credit man. As a rule, in such a case, he will hold the order for more complete reports.

The regular ledger cards are white. Two other shades are used to indicate specific conditions. When for any reason, such as payments becoming slow or local or general financial conditions adverse, an order is refused,

the white card is immediately taken out of the ledger case, and a blue card, with the identical figures and information on it as the white card, is substituted. This shows to the credit department forever after that this man at one time or another was in such a poor condition that he was refused credit.

In the same way, when an account against a customer has once been passed up—placed in the hands of an attorney—a red card is substituted for the original white ledger card, and always remains in the ledger case, even though an account is again opened with the customer. It constantly warns the credit man that once he had


DATE OF YOUR ORDER
DATE ORDER RECEIVED
YOUR ORDER NO. SOLD TO
SOLD BY
VIA
THE SIMMONS MFG. CO.
192 MICHIGAN AVENUE
CHICAGO
INDIVIDUAL NO.
DATE SHIPPED
OUR ORDER NO.
TERMS
30 DAYS NET

EXPLANATORY	QUAN. ORD.	BACK ORD.	QUAN. SHIP'D	CATALOGUE NUMBER, SIZE AND DESCRIPTION	PRICE	AMOUNT	NET

FORM III: The order blank. Four manifold copies are made out. The copy here reproduced goes to the collection department and shows the perforated end which serves as a tickler

trouble with this man and was on the verge of a loss through him, and the card stands as a perpetual warning.

No stain or smirch is harder to eradicate than one on a man's commercial reputation; a fall, even a stumble or slight waywardness, is always remembered, not necessarily against him, but about him, by the careful credit man, and rightly. A man who has once shown insta-

bility, who has once completely failed, has shown that there is some weakness in him; something constant and permanent produced that weakness, whether it was in his character, his ability, his amount of capital, or in his location; very rarely does it happen that it wast merely transient, although there are, of course, exceptions. Once a man's account is upon such a blue or red card, although he may come to have it entered upon his brief that he has completely recovered and is now perfectly sound and trustworthy, still always will his former weakness be brought to the attention of the credit man.

The order O. K'd by the credit man, it goes to the invoice clerk. He makes four carbon copies of the order on the machine. The first one, called the quad sheet, goes to the collection department; the second serves as the bill which is sent to the customer; the two others go to the warehouse for the filling of the order. When the order is filled, one is kept at the warehouse as its record and receipt of the goods shipped; the other is sent back and serves as the source from which to post the ledger The first and second copies, which have been held by the billing clerk pending the shipment of the goods, are sent to their destinations. The one which goes to the collection department is divided into two parts by a perforated line, so that the part containing entry of the individual order number, the date shipped, the order number, the terms and the amount of the invoice can be torn off. This end which is torn off serves as the collection department's tickler; the remaining part of he bill is filed in its numerical order for convenience in reference.

Suppose this order was shipped on March 1st, and the terms are thirty days net. The quad will be filed in the tickler thirty days ahead. On the 1st of April, there-

fore, it will come to the attention of the statement clerk in charge of the tickler. He looks up the ledger account of the customer, and if he finds the bill is unpaid, he will send a statement of the account, which is made in duplicate. The original is mailed to the customer and the duplicate is put over for ten days. A stamp is used on the statement sent out, inviting the dealer to remit by New York or Chicago draft, as the banks charge exchange on local checks, and saying that should the firm not receive prompt remittance, the credit man would presume that the customer wanted him to make a sight draft.

On the 20th, if the ledger accounts show no remittance, draft is made. The draft is filled out in duplicate; the duplicate is sent to the bank through which draft is made; the original is kept for filing in the tickler, ten days ahead.

If the draft is returned dishonored, the account passes into the hands of the collection manager, who is very often the credit man himself. He usually enters into correspondence with the debtor, attempting to place the matter before him in such a light that no more extreme methods will have to be resorted to. Often, when an account has reached this stage, orders are held up until some kind of satisfaction is secured. In this correspondence the debtor is always urged to offer some satisfaction, some form of settlement, however slow it may be; to unburden himself to such an extent that the house may know where it is at regarding the account. A very efficacious method in extreme cases is to telegraph rather sharply immediately upon return of a draft, expressing surprise at the dishonor of the draft and demanding immediate remittance. This will, in the majority of cases, bring payment. If it does not, after one or two letters,

another telegram, very sharp this time, will be likely to bring something. The main thing in these collection methods is to seek to impress the doubtful debtor that the house is watching its accounts sharply; that it wants its money when due; that it is bent on doing business on a business-like basis.

COLLECTIONS *that have reached the legal phase; how these accounts are designated on the ledger cards; methods that insure command of collection work.*

If no satisfaction can be secured through specific means, forcible legal methods must be resorted to. Before any legal steps are taken concerning an account, the matter is referred to the credit man, and is left in his hands. He may make a further effort to secure payment through peaceable means, or may at once hand the account to an attorney for collection.

When an account has been placed in the hands of an attorney, a red ledger card is at once made out for the debtor, and the balance of his account is entered in a suspense account. At the end of each year the balance on the suspense account is examined and an estimate made of the probable percentage of collections to be obtained. Thus, if the credit man thinks that twenty-five per cent of the claims in the suspense account are collectible, seventy-five per cent are entered in the profit and loss account for the year; the other twenty-five are left in the suspense account. Whenever a collection is made in this account, it is credited to it. The object of this suspense account is to keep bad debts off the books, without, at the same time, charging them into the profit and loss account at once, and so necessitating the opening of that account in the course of the fiscal year, a procedure replete in possibilities of errors.

It is thus apparent how the credit man, through his connection with the collection department, which reports to him all accounts overdue more than thirty days, and also all accounts on which drafts have been dishonored, keeps in touch with delinquent accounts. His information is rendered still more accurate from the fact that he handles the remittances in the mail and examines many accounts in the course of a month.

In the particular business in which this house is engaged, most of the heavy buying is done at two distinct periods of the year. Just before these buying periods come around the credit man goes over all his accounts and the reports on all his customers and revises them, getting fresh information and reports in all cases where it appears in the least necessary. In some few cases, of houses on such a firm foundation and reputation that their commercial honor is positively unassailable, it would be a waste of time and energy to get fresh reports. In other cases reports may have been obtained only a short time ago, and so will serve for the coming season. The semi-annual revision gives the credit man a new hold on his accounts and a clear survey.

It is true that this system alone cannot make a credit man; nor can it make a very careless credit man entirely careful. The credit man must do his share; the system will meet him more than half way; in fact, will educate him into careful, conservative habits.

Every man must face some losses; he cannot escape them if he does his duty by the sales end of the business. In describing this system, it should not be understood that the taking of no chances at all is advised. Such a course would be as bad as being too free with credit; but if the credit man does take chances, by proper judgment in picking his chances and by proper

carefulness in setting the terms on which he takes them and the guards he puts about them, he can reduce his chances almost to certainties.

In this connection, the credit man should remember that in carrying out any system for handling credits and collections, his ultimate worth is measured by the quantity as well as by the quality of the business he accepts. Back of every system is the personal element, the guiding policy which must be kept constantly in mind. A system can do much in itself, but, if it is to be a help instead of a burden, it must be carefully adapted to the purpose and policy of the business.

FREQUENTLY *the credit man must take an active interest in the business of some customer who has met misfortune. It must be promptly decided whether the house will endeavor to support the man and tide him over his difficulties or take no further risk and protect itself in the best manner possible. In such cases, the credit man must try to forget his personal friendliness to a great extent. He is representing the interests of his house and those interests are his first consideration. He must know accurately all the conditions surrounding the business of the unfortunate one and be able to decide whether the man will be able to get on his feet if the house continues to support him. It is at such a time as this that the customer will find that his reputation for honesty and fair dealing, enterprise and business ability, established through his confidential and friendly personal relations with the house, are his most valuable asset.*

—Harlow N. Higinbotham

President, The National Grocer Company
Formerly Credit Manager, Marshall Field and Company

XIII

SYSTEMATIZING RETAIL CREDITS

By T. J. Zimmerman

IN the accounting end of a retail credit department, expansibility and promptness are the two essentials: expansibility, because the great retail houses now carry anywhere from five to one hundred thousand accounts on their books, some of which are intermittent, others very heavy; promptness, because it is much more important in retail than in wholesale business to train customers to prompt paying, and this can only be accomplished by submitting bills regularly and quickly.

Accounts are usually opened in a retail store in an indirect way. A customer who is making his or her first credit purchase does not generally make a direct request for credit, but simply has the purchase charged. The clerk who makes the sale, not knowing of course that this customer has no charge account, makes out his usual charge sales slip, indicating that the sale is to be charged. The ticket is passed up to the stamper like any other, and he, not finding the customer's name in his book, knows this is a new customer, and sends the matter up to the credit office.

If the customer wishes to carry the goods away with him on the first purchase, he is usually requested to see the credit manager at once; if the goods are to be delivered, the credit manager has time to investigate the

case at greater leisure. When such a first charge slip comes to the credit manager, or a direct request for credit is made, he sets the machinery in motion for investigating this new customer.

HOW *the retail credit man secures and verifies information on customers; obtaining credit points from personal interviews· recording the facts obtained.*

In the first place he may request a personal interview. In this the two things he seeks to discover are the integrity of the applicant and his resources. The first he must discover through his powers of observation and his ability to read human nature, and also from the consistency of the facts which the applicant gives him. His resources he must find out from direct questions as to the position, income and the property of the applicant. These facts—the applicant's name and residence, place of business, or, where the wife applies, the husband's income and property—the credit manager enters on a blank.

He then proceeds to make use of outside sources of information. He verifies the residence and the place of business of the applicant. He applies to the local mercantile agencies for reports upon the individual in question. These agencies in one way or another accumulate a great mass of information and can afford reports on many individuals, especially those questionable persons against whom they have held accounts for collection, or previous queries, and therefore concerning whom they have collected information. The character and scope of the services of mercantile agencies in this direction are improving, and information on almost any individual of any standing is obtainable. These agencies gather information almost entirely on individuals and not, as a

rule, on firms and corporations distinctly as such.

The regular commercial rating agencies can be appealed to in case the applicant is a man engaged in any commercial pursuits; in this case the credit man will receive the same information that a wholesale credit man would get—the complete facts concerning a man's business record, integrity, property and credit standing.

The credit manager receives every morning the mercantile sheets and legal bulletins which give the bankruptcies and failures of the previous day, the suits which have been brought, both in the higher courts and justice courts, the mortgages foreclosed and chattel mortgages recorded. These sheets are annually compiled into a year book, and into a decade book, so that one book will give the names alphabetically arranged of all individuals against whom suits have been filed, or who have gone into bankruptcy, or against whom mortgages have been recorded or foreclosed in the ten years past. This is a very important source of information to the retail credit manager in a large city.

In the majority of instances a personal interview with an applicant for credit is not necessary, this outside information affording all the data essential for the formation of the credit manager's judgment. Usually the applicant is not even aware that an investigation has been made. It may be said that in a great majority of cases where credit is asked, it is extended. This is done because, in a retail more than in a wholesale house, credit can be guarded and qualified according to the customer's status.

When the credit manager has determined that extension of credit is advisable, he places a definite limit on the monthly credit of the new customer; for instance, he determines from his knowledge of the individual's

reputation, income and resources that he is entitled to a credit of, say, $50 a month. This does not mean that the customer will never be allowed to buy beyond this sum, although no one but the credit manager has discretion to extend credit beyond this sum, and he will do so only after careful investigation; the customer never is told that such a limit has been set.

When an account is opened, the name of the customer and the salient facts regarding him—his residence, business address and credit limit—are spread on all the indexes in the hands of the stampers throughout the store. The duty of these stampers is to approve of all charge sales, and the names and limits in these indexes afford the basis on which they pass on sales. The limit is also entered at the top of the customer's ledger page.

All information collected concerning the customer—his own statements, reports from agencies and other facts—is placed in a folder, which is filed alphabetically in a vertical file cabinet. In this folder is placed also all subsequent information; for instance, if the customer becomes notorious for slow paying or for complaints, or if his account has to be placed in the hands of an attorney for collection, these facts find their way into this folder, and it becomes a complete source of information upon every credit customer of the house. These records are kept in the credit manager's office.

A credit manager's sources of information for credit customers of whom he has a list is therefore threefold. He has in the first place his personal impression of the customer, in the second place he has all the specific facts regarding the customer's history and character in his folder files, and in the third place he has the customer's accounts. Information on all but the gilt-edged customer should be revised at least once a year. For

this the credit manager has his original sources of data to draw from, and he should in addition go over all accounts in the least doubtful.

Now let us go back and follow the course of one charge sale through this system, on the supposition that the customer making the purchase has an open account with the store.

COMPLETE *course of a customer's order from the time the purchase is made until the final entries and records are made by the bookkeeping department.*

When the sales ticket for a charge sale has been made out, it first goes to a stamper to be approved for delivery. There may be twenty-five such stampers scattered throughout the store. Each has an index in which is listed every one of the store's charge customers, in good standing or otherwise.

Opposite each name is set a certain limit of credit. These limits must be revised daily, for the limit here set down is not identical with the customer's regular credit limit, nor is it wholly determined from it; it depends also upon the amount the customer already owes for the current month, how much he has overdue and his general standing. As a further safeguard the stamper is allowed to pass through sales up to only one-fourth of this limit. If the sale calls for a greater sum than this, the ticket must be sent up to the credit office for consideration. It must be remembered that the purchases made by a customer in one visit may go to half a dozen different stampers, so the limit of each stamper must be small. The credit department, having complete information at hand, can determine intelligently and safely whether credit above this limit can be extended.

To follow out the routine, suppose the customer's

total credit limit is $50. Suppose it is the 20th of the month, and the customer has already drawn upon his account to the extent of $20. On the morning of the 20th the credit limit placed beside this customer's name in each of the stamper's books will probably be about $20, and each stamper can pass sales through for sums up to $5. If a purchase exceeds, it is referred for approval to the credit office.

When an account is opened, the new customer gets a card with merely his confidential identification number upon it. He must present this card whenever he wishes to carry away purchases which he has charged. This prevents one person buying fraudulently under another's name. The salesman attaches this card to the sales ticket and it is passed first to an inspector—one of whom is in every department—who has a book with these numbers listed in them and has discretion to pass through sales up to a limit of a few dollars. If the purchase exceeds this limit, the inspector refers it to the floor walker, and if he considers the amount too large for him to pass on it goes up to the stampers, and must pass through the regular routine.

At the end of each day, all charge tickets are gathered together and go into the credit sales section of the bookkeeping department, after they have gone through the auditor's office and been checked there. The charges are immediately posted upon the ledgers. Loose leaf ledgers are used in this system, and the accounts are arranged alphabetically. The ledger sheets are ruled off for three columns: in the first column are entered each day the debit charges; in the second column are entered, in red ink, credits; in the third column is entered the balance due. This column is balanced every time an entry is made in either of the other two, so that

a glance at any ledger page will show at once how the account stands. When a ledger sheet is full it is transferred to the transfer files, also arranged alphabetically, and is filed away in vaults with its predecessors. This enables an establishment to keep together in one place the entire account of each customer, no matter how many years it may have run.

After the posting is completed, the sales slips are passed on to the billing department, and the charges are immediately entered on bills; that is, bills are not made from the ledger account at the end of the month, but sales are posted direct to bills day by day. Therefore, if, on the first day of the month, Mr. Smith makes a purchase of $10 and has it charged to his account, the morning of the 2nd this slip with all the others comes to the bill clerks, and a new bill for the month of June is started for him, upon which first charge is at once entered. The billhead is ruled for three column entries: In the first column are entered the debit charges, not in totals, but with each article of the sale itemized; the second column is used for totaling these individual articles by daily sales; the third column is used for entering credits. The bill clerks keep the bills arranged alphabetically during the whole month, and each day they post the charges from the previous day's sales tickets.

On the last day of the month, therefore, the bill clerk has merely to post the charges of the day, and, without any further work except to total up the columns and subtract the credit from the debits, the bills are complete and can be sent out at once.

The bills are made out in duplicate and the carbon copy is filed in an individual folder for each customer, in a vertical filing case, where are kept all the duplicate

bills for probably the previous twenty-four months.

Retail customers, even more than the customers of the wholesale houses, must be trained to prompt payments. This is true not only because a retail house sells on a close margin and considers after all that it is merely doing a favor by extending such credit, but also because it is impossible to get the close information and the firm hold over a customer that the wholesale house can. The retail house deals principally with women. For this reason collections must be made in a more adroit and less coldly businesslike way. When an account is opened with a customer, especially if she be a woman, she is given plainly to understand that bills must be met between the 1st and 10th of the month, immediately upon receipt of statement. If they are not paid by the 15th a second statement is immediately sent, calling the customer's attention to the oversight and asking for an immediate remittance. The customer's charge sales are not stopped at once unless the account in question is very large, for—and here again because the customers are chiefly women—it is a fatal policy to refuse a woman credit when she has been accustomed to receive it. She is apt to regard such action, which a business man would look upon as an ordinary condition of business, as an insult, and promptly withdraw her patronage.

EFFICIENT *policy to pursue in making collections of store customers' accounts; the personal element; a complete system in use by a department store.*

If the second statement brings no result, personal collectors are sent out. These are all under the jurisdiction of the credit manager. For, as has been said before, this is not purely a business transaction. There

is a personal and human element in it which must be taken into consideration. It cannot be determined on business principles. It must be carried on with an understanding and consideration of human nature as exemplified in this class of customers.

The credit manager of a retail house must above all remember that most people are honest and want to be honest, and that even a greater majority will be honest if they are helped along in the right direction. He must study the personalities of his customers, their social and business conditions especially, so that he will know when it is well to let an account run for two, three and even six months without making extreme demands upon the customer. On the other hand, when a retail credit man has once made up his mind that he cannot afford to get any deeper with a customer, he should act quickly and promptly. The customer must be made to understand that he is not treating the house fairly by not paying his account, and that, although the store wants his account and is glad to have his business, further credit must be refused him until a settlement is made.

The collection system of this store is, therefore, very simple. It uses the two statements mentioned, and after that treats each case individually through collectors under the instruction of the credit manager.

A retail store must be chary of bringing suits for collection Bringing a suit means the loss of a customer in a double sense. The retail credit man always has to keep in mind that his object is to increase sales, and that anything he may do to lessen cash trade is superlatively criminal. If a customer is not worthy of credit, the credit man should at least not turn him away from the paths of cash buying. A suit will mean the

loss of a customer's cash trade as well as his credit trade. Then, too, habitual suit bringing will give a store a bad reputation. The outside world, not knowing the circumstances of the case, will frown upon a store which is known to bring suit frequently and quickly.

Constant pounding by correspondence, by repeated statements and collector's visits, is much more efficacious than stringent measures in bringing payment in the case of the retail house, where a debt is looked upon more as a thing of honor and less as a thing of business.

TWO *main reasons may be assigned for the failure of business men: First, they over-reach themselves in times of prosperity. Second, they take advantage of cheap credit in good times and thus involve themselves in obligations which are difficult or impossible to meet when money is tight.*

When credit is cheap, business men are quick to borrow money where they can get the lowest rates of interest, and they disregard the personal element. In times of financial contraction, cash naturally goes at a premium and notes are not so readily renewed. The business man who raises a loan from a local bank where he is personally acquainted is much more likely to receive the renewal of his note than if the loan were made by a bank in a distant town where cash is needed more than promises to pay and where the personal element does not enter. Such forced payments often lead to the downfall of the borrower.

—Henry Ollesheimer

XIV

THE CREDIT SYSTEM OF AN INSTALMENT HOUSE

By Henry Marcus,
Secretary and Treasurer, Marcus and Klemperer Company

IN every business the collections are a vital part of the credit department, but in no other business enterprise are the collections so prominent and vital a feature as in a business conducted on the instalment plan. In a credit system for the instalment house, therefore, the point of emphasis, the frame about which the structure must be built, is the collections.

Such a system to be successful, must accomplish four objects. First, it must provide a quick means by which the responsible head of a credit department may approve an account. In a retail instalment business sales are made to customers personally in the store, and accounts must be opened almost on the spur of the moment, with little investigation, and, what is even more important, without giving offense or annoyance to the customer, who is probably standing at the credit man's elbow while he is deciding on the advisability of extending credit.

In the second place, the system must afford adequate security for the goods sold, and in this way make up for the almost entire impossibility of choosing customers. Third, since the amount involved is relatively small to begin with, the instalment payments themselves are, of course, still smaller. The bookkeeping required for a

single purchase is considerable, and the system must seek to reduce and simplify it as much as possible. Lastly, the system must provide a cheap and simple but efficient and almost automatic method for making the collections. This is its most important function. The system here described is in use in a large furniture instalment house, and has been found to fulfill these four objects.

SYSTEMS *used by the credit man of an instalment house for taking care of his accounts—the order blank and duplicates; the mortgage; bookkeeping entries.*

When a sale which is to be paid in instalments is made, the salesman makes out an order blank, such as is shown in Form IV. On this blank he enters the name and address of the customer, the amount of the cash payment, the amount and the time of the monthly instalment, and the salesman's name. In the spaces below are then entered the various items of goods bought.

The order goes at once to the head of the credit department, or preferably to a member of the firm, for approval. If approved, the purchaser gives to the house his note for the amount of the sale less the cash payment. This note is secured by a mortgage taken by the seller on the goods sold. The mortgage must at once be taken by the customer before a justice of the peace to be sworn to, and before a county recorder to be recorded. The goods are then shipped to the customer.

This sale order has been made out in duplicate, one to be kept in the office as the original record, the other to be sent to the various department heads, in order that they may find out at once whether they have the goods desired in stock. In the office the order is given a number, by which this sale is known forever after. A

SPIEGEL'S HOUSE FURNISHING CO.

ORDER NO. ________ ____________________ 191__

NAME ____________________________________

ADDRESS __________________________________

TERMS { 1ST PMT ____________ ____________
MONTHLY ____________ WHEN ____________

SALESMAN ________________________________

QUANTITY	NUMBER	MAKER	ARTICLES	PRICE	

RECEIVED OF SPIEGEL'S HOUSE FURNISHING CO.
THE FOLLOWING ARTICLES IN GOOD ORDER AND PERFECT CONDITION

NAME

ADDRESS

LOADER DRIVER

CHECK	QUANTITY	NUMBER	MAKER	ARTICLES

SPIEGEL'S HOUSE FURNISHING CO.

ORDER NO. DATE

NAME

ADDRESS

WHEN HOW

SALESMAN

CHECK	QUANTITY	NUMBER	MAKER	ARTICLES	PRICE	

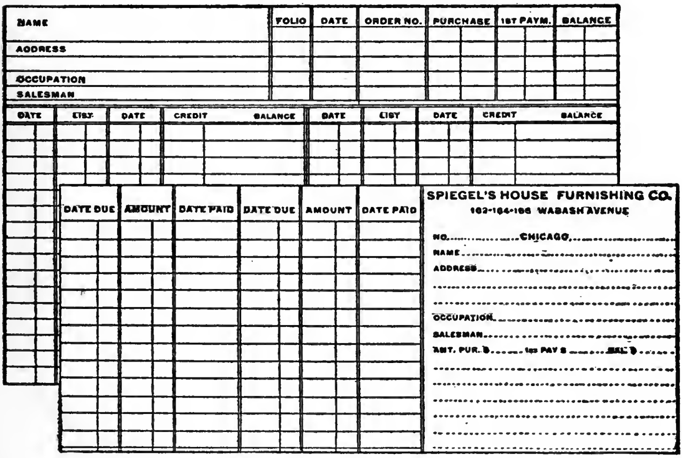
FORM IV: The upper form is the salesman's order blank; the lower is one of the triplicate copies made out in the office; the middle is the driver's copy

clerk then makes out a new order sheet (Form IV) in triplicate from this sales blank, entering thereon the same data as was on the order blank, except that the price goes only on the first sheet. This sheet remains in the office; from it all the office records described below are made. The other two go to the shipping department. One of these, identical with that shown in Form IV, serves as the shipping clerk's assembling sheet. As the various items on the order are loaded on the wagon after being assembled, he checks them off his sheet. Those articles ordered which he has not in stock, and shipment of which he must delay, he circles on the sheet, and at the same time enters on a back order sheet. This he keeps on file and checks off the articles thereon as he receives them from the manufacturer and delivers them to the customer. The third sheet serves as the driver's receipt (Form IV); he carries this with him, has it signed by the customer and returns it to the shipping clerk. When the goods have been delivered, the two sheets which were used in the shipping department are returned to the office and filed numerically for future reference, in case complaint is ever made of non-delivery or delivery of wrong goods.

From the sheet which is left in the office, two cards are made out, one the ledger card, the other the collector's card. All ledger accounts are kept on cards which are filed alphabetically, according to the name of the customer. On the ledger card (Form V) is entered the name and address of the customer, his occupation, the name of the salesman, date of the sale, the order number, the amount of the purchase, the amount of the first payment, and the balance due. In the blanks provided underneath are entered in red ink the dates and amounts of the instalment payments to which the

customer has pledged himself, and spaces are provided for the entry, in black ink, of the date and amount of the actual payments and the balances due after each payment. By comparing the black and the red entries at any time the exact condition of the account can be seen.

Whenever a sale is made, the amount of cash paid down is entered on the cash book, while the amount of the charge, that is to say, the amount of the sale, less the cash payment, is entered in the journal and the folio on which this account is entered is also recorded on the


NAME
ADDRESS
OCCUPATION
SALESMAN
FOLIO | DATE | ORDER NO. | PURCHASE | 1ST PAYM. | BALANCE
DATE | LIST | DATE | CREDIT | BALANCE | DATE | LIST | DATE | CREDIT | BALANCE
DATE DUE | AMOUNT | DATE PAID | DATE DUE | AMOUNT | DATE PAID
SPIEGEL'S HOUSE FURNISHING CO.
162-164-166 WABASH AVENUE
NO. .... CHICAGO, ...
NAME ....
ADDRESS ....
OCCUPATION ....
SALESMAN ....
AMT. PUR. $ ...... 1st PAY $ ...... BAL. $ ......

FORM V: The ledger and collector's cards: Both are similar on the reverse side. The collector's card is placed ahead in the tickler file to come up on the date the next payment falls due

ledger card so that it can be referred to at any time.

The collector's card (Form V) has recorded upon it the same data as the ledger card, but is placed in a tickler cabinet, according to the date on which the next payment falls due. In the case, for instance,

that a sale was made on February 1st amounting to $100, of which $10 was paid down and the first instalment is due March 1st, the collector's card would be filed in the next "1" section of the tickler. On the morning of March 1st the cards in this March pigeonhole, all with payments due this day, are pulled out; each is compared with its corresponding ledger card to see if the payment due has already been made by the customer; and if the ledger card shows that the payment was made say, two days before, the amount of the payment and the date are entered on the collector's card, and it is thrown ahead into the pigeonhole of the next payment, April 1st. The cards of the customers who have not paid are given to the manager of the collection department. He first looks through them carefully to see whether any there are regular, good payers, and not therefore to be dunned. The cards of these customers he takes out and files in the tickler a few days ahead; if by the time these cards come to him again the payments have not been made, he will send the collector to the customers.

The rest of the cards the collection manager classifies by districts into which he has the city divided for collection purposes, and to each of which a collector is assigned. Before the cards are given over to the collectors, the name of each customer and the amount due is entered on a book, which serves as a check on the cards while they are out, and a receipt from the collectors for the cards which they carry. The collectors call on the customers whose cards they hold, and when they return to the store in the evening they record opposite the names in the book mentioned what each customer has done—whether he has paid, whether he has promised to pay on some future date, or whether he was not at home. A clerk then takes the book, collector's cards and

the ledger cards corresponding to them. Where a collection has been made he enters it on both cards and files the collector's card according to the date of the next payment; if a customer has promised to pay, say in ten days, this fact will be entered on the collector's card, which will be filed for March 10th; if a customer has promised to call, this fact is entered on the card and it is filed in a pigeonhole at the cashier's desk according to the day on which he has promised to call. The cashier thus keeps track of these people and finds out whether they do as they promise. The cards of those customers who were not at home are again taken out by the collector on the following day.

HOW *customers' payments on accounts are entered on the ledger cards; how future payments are provided for; the method used for filing the reports.*

When a payment is made at the office, it is at once entered on the ledger card, which is quickly found, as it is filed alphabetically. From the dates in red ink on the ledger card it can easily be determined in what pigeonhole of the tickler the corresponding collector's card is, and so this card can be looked up, the payment entered, and the card filed ahead for the next payment.

Should a new purchase be made by a customer while a previous instalment account is still open, the ledger and collector's cards of the old account are also used for the new. The date and amount of the cash down payment are entered, as before, the amount of the monthly instalment payments, entered in red, are changed to correspond to the increase brought by the new purchase, and the balance due will also be increased. This combining of payments saves collection labor and confusion.

When an account is paid up, both cards are stampe paid and filed away alphabetically. Thus, a custome who has had twenty or thirty accounts with this firn will in all probability have twenty or thirty old ledge cards and they will be all filed together, so that hi record can be looked up at any time—a valuable asse in a business of this kind with thousands of customer and information regarding them hard to obtain.

The value of the card ledger for this kind of busines cannot be over-emphasized. Whatever may be the ad vantages in other kinds of accounting, for instalmen accounts it seems almost indispensable. With so man small accounts, requiring so many small and frequen entries, the keeping of accounts in the old-time heav tome, unwieldy and cumbersome, would more tha double the office work. The inevitable scattering o different accounts of the same customer throughout vari ous volumes would render it impossible to study then all together, and would thus destroy the most valuabl source of information of the instalment house. Th ledger cards also serve as an alphabetical index of al customers, an immense saving of time and money whicl would be required to keep so necessary a record.

AFTER *all is said, the credit man much prefers to meet his customer face to face. In this way he can bring into effect all his power of judging personality. I presume that I have made mistakes in reading men's faces, but I am usually able to decide very promptly by a man's talk and appearance whether he is honest or dishonest. I can read it in his countenance, his talk and his manner.*

—Harlow N. Higinbotham

President, The National Grocer Company
Formerly Credit Manager, Marshall Field and Company

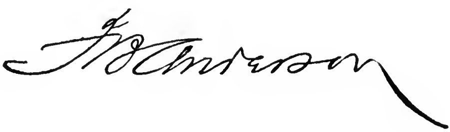
PART IV—INVESTMENTS, CREDIT AND FINANCE

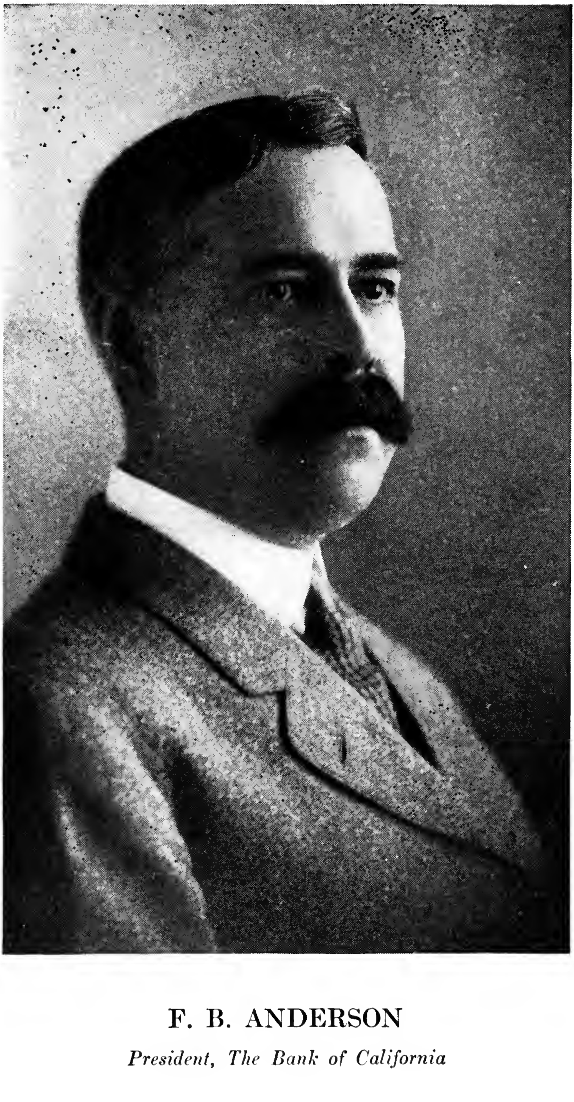
Work with Your Banker

BANKERS in all sections of the country are often handicapped in their efforts to help their clients, particularly the smaller ones, owing to a lack of knowledge of their affairs.

Few business men seem to realize that they are neglecting an available asset which could be made to be of great service if used in the right way, that is, by keeping in touch with their banker. Educate him—quietly, but persistently. He is the same kind of a human being that you and your associates are and will take more of a personal interest in the things that he understands best.

One often hears the complaint that the bank measures every business with the same yard stick. But take the trouble to discuss your affairs freely and frankly and intelligently with your banker, and perhaps he will know what kind of a measure to use in your case.





F. B. ANDERSON

President, The Bank of California

XV

FINANCING A NEW ENTERPRISE

By Henry Clews
of Henry Clews & Company

VIEWED from the banker's standpoint, the financial beginning of a commercial venture is the stock issue. This is the first step in the business development known as industrial increase. The issue of the stock also brings about the first, the most personal and most vital relation that ever exists between a banking house and a manufacturing or selling organization.

The organizers of the corporation, rather than the banker, however, should take the first step and decide the direction of the stock issue. Few men will lay the foundation of a corporation without figuring the costs, reviewing their forces and assuring themselves of their ability to meet their obligations. This study of their problem will suggest to these organizers the investors most likely to be attracted by the new venture. For this reason, it is better that the business man determine the most advantageous disposition that could be made of the stock issue of his enterprise before he consults a banker. In fact this will sometimes denote also the house best adapted to handle his securities.

There are many conditions that may influence the placing of stocks. There are always those timely conditions that arise during the formation of the enterprise and that are more or less personal; and, in addition,

there are the great fundamental questions that present themselves to the observant minds in all undertakings.

First, let me name the chief of these questions; and afterward give them specific application. They run something as follows: When is it best to retain the stock issue entirely within the active management? When is it most advantageous to interest only local capital? When is it desirable to include those particular commercial interests that seem likely to come into close relation with the proposed industry? When is it wisest to put the stock on the open market without any means of directing its purchase?

These are the four most important questions. It must be taken for granted, to give the illustrations force, that the operations taken under consideration are of such evident worth and stability, that the method of distribution conceded to be the best is always possible. Obviously, as has been already suggested, there are very often reasons known only to the organizers, that compel the distribution of stock in a manner not at all in accordance with the general principles.

WHEN *the capital stock of an enterprise should be retained within the organization—restricting the distribution of the shares of a retail concern.*

Under ordinary conditions, it is desirable that a retail mercantile concern should retain the capital stock within the limits of its organization. Only those who have had experience should be permitted to dictate the policy of a concern that must appeal directly to the diversified tastes of the general public. They must not only know the goods demanded by those within the radius of their district; they must be able to anticipate the impression that they make upon the public at every point of con-

tact and never permit personal tastes to enter into the result.

This method of operation must be carried into the smallest details. Store decorations, window trimming, personnel of employees, location of departments—a thousand points that an inexperienced stockholder might endeavor to block with "I don't like this, or that or the other." If outside capital must be secured, let it come from those who have implicit confidence in the organizers and who will consider it only as a profitable investment.

Of more general application is the second proposition of interesting local capital. In speaking of local capital, I refer neither to investors who will be actively interested in the management of an industry, nor to those who would invest from a feeling of friendship or confidence through long and intimate acquaintance with the promoters. I use the term local capital to indicate merely a geographical standpoint.

Take for example the interurban trolley, the gas, electric light, or water company of the smaller city. Nothing will aid it so much in its work of construction, its securing and retaining patronage, as having its shares scattered among the merchants and professional men of the community. This system of distribution has also proved most beneficial to local telephone companies and has greatly aided them in gaining the loyalty of the subscribers. The very apparent worth of this plan removes any need for further elaboration.

Manufacturing and retail concerns may also frequently follow this method and to very good advantage. Every community is pleased to see its business activity on the increase and may usually be depended upon to lend financial as well as moral support.

As to the actual task of placing shares locally, there

are various methods that may be pursued. Often the organizers will personally solicit the merchants and capitalists of the city where the business is to be started. This plan has proved particularly successful where some member of the concern already holds local interests in good standing.

Another business-like method is to retain the service of some man of clean reputation and appearance, and to send him out like any other salesman with a carefully selected list of those who would most probably be interested. A personal letter sent in advance to each prospective buyer will serve as an introduction and will show that the representative has authority. This salesman need not be experienced, for any bright young man can be coached, in a very short time, so that he can answer any pertinent question that may be asked.

Advertisements in local papers often bring very good results when used in connection with either of the before-named plans. These notices should state that particulars will be sent on request; that a representative will call if desired; or that any interested person will be welcome between certain hours at the company's office, where a member of the organization will be pleased to give all information.

The publicity method is good also when a local banker has charge of the sale of shares. In fact, to win over the local press by spending some money with it is seldom a poor investment, for you are sure to get generous news items and kindly gossip.

Where it is not possible or wise, with ventures of this class, for the organizers to attempt placing the shares, then is the time to have the matter handled through a local banker. These men are known to be versed in affairs of this kind and they know where capital is to be

found. The presentation of a proposition of this kind, where local organizers have to deal with a banker of their community, merely demands a meeting between the two parties and the giving of all details by the organizers to the banker. When the latter is not able to take shares direct to capitalists whose names are on his books as ready investors he follows the same method as has been outlined for use by the company when they place their stock themselves.

DISTRIBUTION *of stock among dealers in the same line is one of the most advantageous methods of financing manufacturing and wholesale ventures.*

The third plan of financing is one that requires most careful review and it may be said to relate particularly to manufacturing and wholesale ventures. There are a number of reasons why it is desirable for a manufacturing concern to have some of its stock placed with houses handling its goods, provided these houses are sufficiently scattered to remove all possibility of competition among them. These stockholding customers will take the factory's goods and advertise them to the best advantage. They will take the trouble to send in suggestions as to the needs of their district. They will be more reasonable in their demands. And the factory will be sure of its customers, for the provocation must be great that will compel a house to buy from a rival of one in which it holds stock.

These same advantages apply to the wholesaler who places his stock in the hands of large retailers in various cities. Throughout the entire retail organization, down to the clerk behind the counter, the command is given to "push" the products of this dealer.

But the danger in all this is that one customer-stock-

holder may become so powerful as to dictate the efforts of the manufacturer or wholesaler, to the detriment of the other customer, or he may dispose of his stock to a rival manufacturer or wholesaler, who may be endeavoring to compel a combination, or hoping to secure enough stock to take over the rival.

Some of these difficulties may be avoided by having the stock before any attempt is made to dispose of it agrees to give the company an opportunity to buy back the stock before any attempt is made to dispose of it elsewhere. This is especially advisable where it is desired to keep control of the stock, where there is danger of its getting into unfriendly hands, or where the organizers wish eventually to hold all the stock.

The fourth plan is to go with your stock into the open market, or, more properly have it taken there. The desirability of this method relates to those branches of commerce that may be termed national industries; in fact they are the only form of enterprise that is admitted. Wall Street does not recognize the terms "close" and "open," as applied to small corporations. In this financial center the word "corporation" is only considered in connection with industries of the greatest scope and appraised value. And to these concerns, Wall Street is the only possible outlet for their securities. The extent of their enterprises is so gigantic that it would be impossible to choose their stockholders. The interests quoted in Wall Street are usually the outgrowth of an amalgamation of smaller concerns already in operation.

In regard to the formation of a national industry, it is without question the better plan to represent the matter to a banker in one of the largest cities. It is hardly possible to outline a method of procedure to be followed

in putting such a proposition before a banker, for, as has been stated, a corporation planning this form of distribution for its stock, must be of considerable importance in both the industrial and financial world. Bearing this fact in mind, it will be seen that many of the larger banking houses will at the beginning have some intimation of the nature of the new concern and of those who are back of it. Should the affair be kept an entire secret it would only need the presentation of an outline of both purpose and personnel to the banker whose former operations have shown him best adapted to handle the work. If this introduction is favorably received, the next step is to arrange an interview, at which time an experienced banker would readily be able to present the terms upon which he would undertake the placing of the shares.

BANK *aid in selling stock for new enterprises; underwriting of stock issues; how the cooperation of the bank opens the field for securing investments.*

The banker may underwrite the entire amount of stock to be put on the market or he may charge a percentage commensurate with the task at hand. Should he pursue the former method, it is because he is so confident of the success of the venture that he will take over the burden for the hope of the greater reward that will come through a rise in values. When a per cent is charged, it usually varies from one to two and a half, the banker making no promise to place the whole block that is for sale. He lends the great support that his name will give to the undertaking and he uses the experience that years of intimate contact with such work has provided. He knows all the possible outlets, in their order, from the most likely to the least probable. He

knows how to make the introduction that means so much in regard to a favorable reception for the interests of the venture.

In the actual methods the banker employs in placing the securities which he has undertaken to dispose of, advertising along the usual lines is one of the greatest factors. He cooperates with the promoters in the preparation of a prospectus that states fully and clearly the purpose of the new enterprise. Advertisements are then placed in mediums known to reach persons who have money to invest. This publicity seldom consists of more than an announcement of the barest facts, concluding with the request that prospective investors send for more detailed information, and to these the prospectus is mailed, with any further information relating to conditions that may have developed since its compilation.

As to the other questions that may arise when the task of placing securities is considered, it is not unlikely that the banker may be able to shed some light upon them. Frequently the personal questions that come up are given more attention than their value demands. At these times and on these questions, the experience of the banker is often valuable in putting them in their right relation, or of pointing the way to their removal, to the benefit of the organization.

CREDIT *is usually extended on the strength of the "quick assets" shown in the financial statement. While real estate and machinery may be good assets, yet their immediate market value is uncertain, and consequently accounts and bills receivable, and merchandise which can readily and quickly be turned into cash are the principal items taken into consideration in the making of bank loans.*

—William B. Lavinia

XVI

PUTTING CREDIT EXTENSIONS ON A SOUND BASIS

By Howard R. Huse

MUCH of the criticism uttered against bankers for refusals to grant credit is due to a misconception of what is safe and legitimate banking, and failure to understand the exact position of the banker. A banker is often regarded in much the same way as a private money lender. The necessities of his position are not taken into account.

In financing a business there is nothing more important than to know definitely the relation of the banker to business. This knowledge insures not only sound financial principles, but the ability to make the maximum safe use of the banker's services.

A banker is not lending his own money, or money which is under his permanent control. The deposits of a commercial bank are temporary funds, and, while they are not likely to be called for all at once, it is a fundamental principle of sound banking that they be kept "liquid," that is, in temporary investments, constantly being liquidated and re-invested. Therefore in applying for bank credit, the business man should determine whether the funds he asks for will be kept liquid, whether or not the banker can grant him the loan without violating this first principle of sound banking.

A banker should not be expected to furnish any part

of the permanent capital required in any business. This money should be obtained not from banks, but on long time loans or on bond issues from private investors. The firm's bank credit should be preserved and held in reserve as a resource for temporary needs, to enable the firm to discount bills, to take advantage of markets, or to meet temporary emergencies. The money obtained from banks should exclude the amount which is required for carrying on the business under normal conditions.

In the second place a business man should be able to show the banker the exact condition of his business. Many business men fail to get credit because they fail to present their affairs in a way that will assure the banker that he is not taking risks. One person will make a more convincing showing of the same case than another, but if a man does not have his affairs in an orderly condition, or show a good grasp of them, that in itself argues against him as a credit risk. In these days of keen competition, there is a presumption against the success of any one who does not have a good grasp of the details of his business. The man whose affairs are in confusion, who does not have fresh and detailed inventories, who neglects his collections, who is careless about insurance, who does not systematically calculate his costs, and, in short, who does not keep his affairs in perfectly intelligible condition, is not deserving of credit, and in most cases will not obtain it.

CHARACTER *is the foundation of credit; assurance that the character of an applicant for a loan warrants trust is the banker's first consideration.*

The first thing to be known about a proposed loan is the character of the borrower. The banker is entitled to a full history of his business. He is entitled to know

how he has paid his debts, how he has kept his promises, if his expectations are based upon knowledge and intelligent forecasts or upon mere guesses. The business man in applying for a loan should be careful to show up these facts upon his own initiative. If he is a recent arrival in the community he should show what his record has been in the place where he formerly lived. If he has never been in business for himself, he should show what his personal record has been in someone's employ. No one can expect to borrow money without showing his personal worthiness, as established by years of upright life, and the more promptly and fully he shows this up, without being pressed for it, the more favorable the impression he will make.

Together with personal character for integrity and reliability, the banker closely associates the established character of the borrower for business capacity. The borrower must show what his experience has been and what success he has had. All this has a direct bearing upon his claim for credit.

Moreover, the borrower must have a proper proportion of capital of his own in the business, and should be able to show that what he borrows from the bank is for temporary use and will correspondingly increase his quick assets. Everything that he owes the bank should be offset by merchantable stock that in the natural course of trade will be moved in a few months. It is not prudent either from the standpoint of the borrower or of the bank to have the bank supply money for investment in plant or real estate. By doing this the borrower places himself in a position where he might be obliged to liquidate his whole business in order to pay a short time loan.

The employment of audit companies is very desirable

where a business has attained considerable magnitude, so that the head of the house is in a measure dependent for his own knowledge of conditions upon subordinates. There is always the possibility of irregularities which escape his notice. Banks are encouraging their customers to have an independent audit made at frequent intervals. This practice inspires confidence, and where the accountants are capable and experienced men they often are able to give valuable advice as to bookkeeping and managerial methods. Finally, if a man expects frequent accommodation from his banker he must be open and candid in his representations, recognizing that the former has a right to know all about his business and cannot be satisfied with generalities. Nor is it well to change bankers. Build up with one, borrow only from him, and let him be assured that he is your only creditor. If his advice seems unnecessarily conservative at times, remember that you are likely to be a little biased on the side of your business, and that he judges by the record as it is. Too many men seem to be lacking in power of analysis, or the concentration required for a close knowledge of details. Too many, when it comes to the test, are lacking in knowledge of their own business, or are trying to fool themselves about it, unwilling to face unwelcome facts. It is usually fortunate for themselves as well as for everybody else concerned, if the banker detects their incompetence and denies the accommodations they want.

The information demanded by the banker is verified and supplemented by the information that the bank obtains through its own investigation.

Fifteen years ago the credit manager was almost unknown. Today the systematized credit department is the nerve center of every thoroughly organized bank; and

the plan is spreading rapidly to the smaller banks.

What the president and cashier formerly carried in their heads, the credit department now carries in its files—and vastly more.

There are so many facts to be taken into account, so many influences that might affect a loan, that the credit departments of the large banks are organized with the greatest care. This organization embraces a system for gathering and filing statements, records and reports, and the men who turn an x-ray on those statements and determine when a customer is entitled to credit and when further loans must be refused.

One of the important functions of the credit department is known as "statistical" and the data that it gathers for the bank would be a revelation to the majority of customers.

The information which the credit department desires is literally unlimited; any fact related to the individual's past record, the condition of his business, his personal habits, his integrity, his domestic life—nothing is too trivial to have bearing on the case. On the one hand the bank must guard against questionable loans; on the other hand it must be equally careful not to offend an influential business man by denying him accommodation to which he is entitled. To steer this department in safety, the channel of business life must be charted with infinite precision and the changes made by the current from day to day must be known to the pilot.

A common characteristic of borrowers is self-deception. When a man succeeds in fooling himself, he will try to fool the bank. If he admits the truth himself, ordinarily he will set it forth in his statement.

A merchant made verbal application for a loan. During the conversation he stated that he carried a stock

STATEMENT OF REAL ESTATE

GIVE LOCATION AND CASH MARKET VALUE OF EACH PIECE, AND AMOUNT OF ENCUMBRANCE, IF ANY.

....

....

NAME ....

BUSINESS ....

LOCATION ....

TO **STATE BANK OF CHICAGO**

THE UNDERSIGNED, FOR THE PURPOSE OF PROCURING CREDIT FROM TIME TO TIME FROM THE STATE BANK OF CHICAGO FOR THE NEGOTIABLE PAPER OF THE UNDERSIGNED OR OTHERWISE, FURNISHES SAID BANK WITH THE FOLLOWING TRUE STATEMENT OF THE FINANCIAL CONDITION OF THE UNDERSIGNED ON THE .... DAY OF .... 191.....

THE UNDERSIGNED AGREES TO NOTIFY SAID BANK PROMPTLY OF ANY MATERIAL CHANGE IN THE UNDERSIGNED'S FINANCIAL CONDITION, AND AGREES THAT IF THE UNDERSIGNED AT ANY TIME BECOMES INSOLVENT OR COMMITS AN ACT OF BANKRUPTCY, OR IF ANY OF THE REPRESENTATIONS MADE BELOW PROVE TO BE UNTRUE, OR IF THE UNDERSIGNED FAILS TO NOTIFY SAID BANK OF ANY MATERIAL CHANGE AS TO BEFORE AGREED, THEN, AND IN ANY SUCH CASE, ALL OBLIGATIONS, EITHER DIRECT OR CONTINGENT, OF THE UNDERSIGNED HELD BY SAID BANK SHALL IMMEDIATELY BECOME DUE AND PAYABLE WITHOUT DEMAND OR NOTICE, AND THE SAME MAY BE CHARGED AGAINST THE BALANCE OF ANY DEPOSIT ACCOUNT OF THE UNDERSIGNED WITH SAID BANK.

ASSETS		LIABILITIES	
CASH ON HAND		BILLS PAYABLE FOR MERCHANDISE	
CASH IN BANK		BILLS PAYABLE FOR BORROWED MONEY—TO OWN BANK	
BILLS RECEIVABLE, ALL GOOD, DUE FROM CUSTOMERS		BILLS PAYABLE FOR BORROWED MONEY—FOR PAPER SOLD	
BILLS RECEIVABLE, DUE FROM PARTNERS		BILLS PAYABLE TO PARTNERS	
ACCOUNTS RECEIVABLE, ALL GOOD, DUE FROM CUSTOMERS		ACCOUNTS PAYABLE	
ACCOUNTS RECEIVABLE, DUE FROM PARTNERS		ACCOUNTS PAYABLE TO PARTNERS	
MERCHANDISE, FINISHED, AT ACTUAL PRESENT CASH VALUE		LOANS OR DEPOSITS WITH FIRM BY EMPLOYES OR FRIENDS	
MERCHANDISE, UNFINISHED, AT ACTUAL PRESENT CASH VALUE		MORTGAGE OR LIENS ON REAL ESTATE, WHEN DUE	
RAW MATERIAL, AT ACTUAL PRESENT CASH VALUE		CHATTEL MORTGAGES	
STOCKS, BONDS AND INVESTMENTS (SEE PAGE 3)		OTHER LIABILITIES, VIZ:	
MACHINERY AND FIXTURES			
REAL ESTATE, AS PER SCHEDULE, PAGE 2			
OTHER ASSETS, VIZ:			
		TOTAL LIABILITIES	
		NET WORTH	
TOTAL		TOTAL	

DR.	PROFIT AND LOSS ACCOUNT, FISCAL YEAR ENDING 191	CR.	
ACTUAL EXPENSE OF CONDUCTING BUSINESS		GROSS PROFITS	
BAD DEBTS CHARGED OFF		FROM MERCHANDISE	
WITHDRAWN BY PARTNERS		FROM INTEREST AND DISCOUNTS	
WITHDRAWALS, OTHER THAN ABOVE		FROM INVESTMENTS	
NET PROFITS		FROM OTHER SOURCES	
TOTAL		TOTAL	

(SIGN HERE) ....

DATE SIGNED .... 191.... BY ....

NOTE.—PLEASE FURNISH IN DETAIL THE INFORMATION CALLED FOR ON FOLLOWING PAGES.

FORM VI: At the left are shown the first and third pages of the statement blank used by the State Bank of Chicago. This shows the line of information demanded from applicants. Page three of this blank provides

FILL ALL BLANKS, WRITING "NO" OR "NONE" WHERE NECESSARY TO COMPLETE INFORMATION

HAVE YOU ANY CONTINGENT LIABILITIES?
- UPON REDISCOUNTED BILLS RECEIVABLE ______ $ ______
- UPON ACCOMMODATION ENDORSEMENT ______ $ ______
- UPON NOTES EXCHANGED WITH OTHERS ______ $ ______
- FOR GUARANTEES ______ $ ______
- FOR BONDS ______ $ ______

TOTAL AMOUNT OF BILLS RECEIVABLE DISCOUNTED AT BANKS OR SOLD BEARING YOUR ENDORSEMENT ______ $ ______

ARE ALL BAD AND DOUBTFUL ASSETS EXCLUDED FROM ABOVE STATEMENT? ______

WHAT AMOUNT OF BILLS OR ACCOUNTS RECEIVABLE IS PAST DUE OR EXTENDED? ______ $ ______

ARE ANY OF YOUR ASSETS PLEDGED AS SECURITY FOR LOANS ADVANCES OR OTHER LIABILITIES? ______

______

ARE ANY OF YOUR BILLS PAYABLE SECURED? ______ IF SO, WHAT AMOUNT? $ ______

AVERAGE AMOUNT OF MERCHANDISE CARRIED, $ ______ TOTAL SALES FOR LAST FISCAL YEAR, $ ______

AMOUNT OF FIRE INSURANCE: ON BUILDINGS AND PLANT, $ ______ ON MERCHANDISE, $ ______

DATE OF PARTNERSHIP AGREEMENT ______

WHEN DOES IT EXPIRE? ______

GENERAL PARTNERS

NAME	ADDRESS	WORTH OUTSIDE OF BUSINESS
		$
		$
		$
		$
		$
		$

NAMES OF SPECIAL PARTNERS ______

AMOUNT OF SPECIAL CAPITAL, BY WHOM CONTRIBUTED, AND UNTIL WHAT DATE? ______

______

GIVE NAMES OF ALL BANKS WHERE ACCOUNTS ARE KEPT ______

______

GIVE NAMES OF ALL BANKS WHERE ACCOUNTS HAVE BEEN KEPT ______

______

NAMES OF BROKERS HANDLING YOUR NOTES ______

______

REGULAR TIMES OF BALANCING BOOKS ______

REGULAR TIMES OF TAKING INVENTORY ______

STATE LAST DATE OF TAKING TRIAL BALANCE AND IF SAME PROVED ______

HAVE YOU EVER FAILED IN BUSINESS ______

space for statements of stocks, bonds and investments and the names of concerns from whom goods, merchandise and material are purchased

worth $40,000. He was given a blank to fill out. When he came to the item "Merchandise" he hesitated, for under this line in small italics, was the qualification: "How valued?"

He laid down his pen and meditated. Then he figured a moment on the pad, and finally entered his merchandise item as $24,000, instead of $40,000. The latter was the retail valuation, and included his unearned profit. He had been deluding himself with the belief that he actually had $40,000 in goods. When the banker saw the statement, he remembered the valuation the applicant had put on his stock and called his attention to the discrepancy. The borrower had to confess that he had talked loosely. It is vastly better to get down to cold facts at the very beginning. To do it under pressure lessens confidence.

WHAT *specific information is required of an applicant for a bank loan; the character of the information demanded; the details of the statement blank.*

In gathering its information the credit department has three sources: the statement rendered by the applicant for a loan; the record of the account in previous months and years; and, finally, the reports from mercantile agencies and facts that can be obtained independently of the bank's records and the interested person.

In applying for a loan a borrower is requested to fill out a blank, giving specific information concerning his assets and liabilities—questions that "must needs give him pause" unless his business is in shape to make at least a fair showing. Separate forms are usually provided for individuals, co-partnerships and corporations, although naturally many of the questions are the same in all forms. The blank used by the State Bank of Chi-

cago (Form VI) shows the line of information which the customer is expected to furnish; the failure to answer any question merely serves to arouse suspicion and is certain to hold up the application pending further investigation.

Once a year or oftener these statements must be revised and an emphatic clause in all of them requires the borrower to notify the bank at once of anything that changes his standing as to assets or liabilities.

The degree of detail varies with different banks. Some peculiar experience, perhaps, induces one bank to ask questions not deemed important by others. Sometimes a blank statement will show extraordinary minuteness, for example, in matters pertaining to previous history. A record is perhaps required of all former enterprises, names of all banks where previous accounts have been kept or where money has been borrowed; names of brokers dealt with during a decade, names of all large creditors of the past, and all partners and others connected in a prominent way with earlier enterprises.

The National City Bank, in gathering credit information places great stress on everything that shows the borrower's integrity, no matter what that information may be; next, it ranks ability, and places tangible assets last. The Corn Exchange Bank of Chicago, asks, among other liability items: "Due to wife or relatives in any form of obligation?" This bank aims to guard against entanglement resulting from family litigation and claims. Some banks ask specific information about credit insurance carried and life insurance payable to company; others want a valuation placed on "good will, patterns and patents." The State Bank of Chicago, for instance, requires the borrower to agree in writing that should he become insolvent, or commit any act of bank-

ruptcy, or if his representations are untrue, or if he fails to notify the bank of material change, all obligations held by the bank are to become due and may be charged against the deposit balance. From its own books the bank compiles a condensed statement showing the average balances and maximum loans from month to month.

The average statement required by a city bank makes a borrower dig down to the blunt reality. He may have been deluding himself, but if he answers the questions honestly he often finds he must discount his former estimates heavily.

Borrowing money at a bank is something like selling. Delusions no longer count. What the bank wants to know is rock bottom facts. Although sometimes even the bank may be deceived, the modern credit department is steadily lessening the danger.

Between commercial bank credit and credit from the jobber and manufacturer there is a fairly close analogy. Quick assets are the basis for figuring both, though real estate and the money invested in buildings and equipment are also taken into consideration in fixing the amount of accommodation granted to a borrower.

BANKS *consider the moral risk important. Information comes from many sources. Sometimes a stray bit of news is received by accident; sometimes the bank sends out to gather desired facts. If anything transpires to arouse suspicion, the moral risk is investigated by special agents. Integrity and ability play parts as conspicuous as tangible assets. Many business men place chief dependence on their property—and commonly put their fixed assets ahead of liquid assets. As a matter of fact, the bank looks upon liquid assets as far more significant that property such as real estate and equipment which cannot be quickly turned into cash.*

—Edward Mott Woolley

XVII

THE BANKER'S CREDIT VIEWPOINT

By George M. Reynolds
President, The Continental and Commercial National Bank

EXTENSIONS of credit to one of its customers a bank bases on the assurance that the borrower could pay, when called upon to do so, out of his quick assets.

Bank or short-time credits do not contemplate that the proceeds of such loans should become a part of the fixed capital in the borrower's business, but rather that they shall constitute the increase in capital necessary for the conduct of the business during a portion of the year where the full amount employed is not necessary or cannot be used profitably throughout the entire year.

A bank loans money to a business man only for temporary purposes, and when it will increase the liquid assets of the borrower so that a quick turnover will enable him to pay the loan. Therefore, the amount of credit to be extended must depend very largely upon the amount of quick assets possessed by the applicant.

Although there is no definite rule covering the percentage of quick assets to total liabilities required, still, from the banker's point of view, the applicant should possess two dollars or more of quick assets to one of liability. The only basis for a bank loan is a volume of quick assets sufficient to take up the loan and leave enough surplus quick assets to protect the business.

A borrower's fixed assets—such as his investment in land, buildings, machinery, equipment—are not considered by the bank as a direct factor in determining the advisability or the size of a loan to him. Fixed assets have a bearing; they help determine the standing, the stability and the ultimate worth of the borrower. But they do not enter into this one important question the banker asks: "What will pay this loan promptly at maturity?" Prompt payment of a short-time loan must come out of surplus liquid assets.

QUICK *assets should at all times exceed quick liabilities—this is necessary from the viewpoints of both the borrower and the lender.*

An applicant for a loan whose margin of quick assets over quick liabilities is not more than one-half, is not held by a bank to be as desirable as where the percentage is greater; for, if there is not a sufficient margin of quick assets, a borrower, should he be forced to pay quickly, might find it impossible to do so without serious damage to his business. So, from the banker's point of view it is desirable that borrowers should possess quick assets, in excess of the liabilities, at least equal to the loan, for that insures the borrower's ability to pay, should he be called to do so.

Loans made to concerns whose percentage of quick assets is not largely in excess of the liabilities, for all practical purposes, put the bank in the attitude of furnishing money to be used as capital stock in the business of the borrower. And it certainly is not the province of a bank to do this. To avoid this a bank insists that the borrower shall have a sufficient excess of quick assets over all his liabilities to enable him to repay the loan without impairment to his business and without the

bank's being forced to take the time to collect the loan. Either of these results might occur if the borrower had to pay the loan in part or in whole from his capital, represented by his fixed investments.

As a general principle, a loan is protected and a prompt payment insured only by maintaining a ratio of at least two or more of quick assets to one of quick liabilities. The surplus of assets should at least equal the amount of the loan. The difference between the two establishes the net worth of the borrower and his ability to pay quickly, from the bank's standpoint—the net that makes it possible for the bank to get its money when payment of the loan is demanded.

This ratio is necessary for two reasons. Liquid assets, like all assets, have a tendency to shrink under liquidation, while liabilities remain stable. When a borrower's quick assets are only a half larger than his liabilities, even though that half covers his loan, yet the risk may become unsafe because the margin of shrinkage for assets is too small.

In these days of rapid development and large growth in business, the tendency is to require greater facilities for the conduct of business. This puts a constant pressure on the borrower to convert liquid into fixed assets. Naturally the banker is inclined to discourage this. He believes that where a greater equipment is necessary, requiring a larger investment of money, the capital of the concern should be increased sufficiently to provide the money necessary for this extension; it should not depend upon the proceeds of short time loans for promoting such expansion.

This ratio ignores time as an element in the loan. For if, when the loan comes due, the borrower still maintains a proper margin of quick assets to liabilities the

banker has no hesitancy in extending the loan; the risk is just as good as it was when accepted; the loan is still well protected; payment could be made if demanded.

This might be continued indefinitely. But to prove himself, to assure his actual ability to pay, and to preclude his too great dependence on bank funds, the borrower should clean up periodically—pay up his loan and actually show his excess of quick assets over quick liabilities.

REGULAR *cleaning up periods show the banker that his loans are protected and prevent borrowers from reducing quick assets below the margin of safety.*

Cleaning up periods will vary according to the size of the business, the loan and the character of the industry. A reasonable period for cleaning up is every eight months. In some industries, which do a seasonable business requiring a full year for a complete turnover, a yearly clean-up is sufficient.

These rules of ratio and clean-up have their exceptions. There are industries whose turn-over is so quick that they do not require so large a ratio of quick assets. In other lines there are seasons when more ready money is required than such a ratio allows, and so there may be exceptions to the rule in those periods; for instance, a grain company, during crop-moving time. Sometimes a merchant has a chance to make a quick turn and needs a relatively large loan for a short time; knowing his condition and just what he is going to use the money for, the banker makes an exception to the rule by accommodating him. In fact, circumstances are so varied that the rule is just as dangerous without well judged exceptions as would be the entire ignoring of the rule.

After the clean-up the banker should require a full

statement from the borrower, for this tendency to convert liquid assets into fixed capital is strong in many lines of business. A concern has $100,000 in fixed assets, $60,000 in quick assets and $30,000 in quick liabilities. It borrows $20,000 from the bank. This is likely to release some of the quick assets and immediately the demand for a greater equipment creates a tendency to convert some of those quick assets into fixed assets.

The borrower gets the idea that, since his volume of fixed assets is large, the loan can run indefinitely; and when clean-up time comes his banker finds the bank's funds are being used as a part of the working capital of the concern. The proportion of quick assets to liabilities has grown smaller than at the time the loan was made; in this case the payment of the loan may necessitate liquidation of some of the fixed capital in order to restore the proper ratio. And to do this may require considerable time or result in embarrassment to the borrower.

A proper margin of quick assets to liabilities is always a factor of safety. It should exist at all times, and the bank can prove if it is being maintained by testing the borrower's ability to pay, by calling the loan.

The test of the ability to pay is the excess of quick assets against quick liability. It should be the measure of borrowing power.

ONE *achievement of the bank credit department has been a raising of the standard of business. Men who have to answer rightly the questions put to them by the bank, and live up to the rules of the code, are sure to be better business men and build stronger businesses. It really has helped the borrower as much as the lender.*

—Edward Mott Woolley

XVIII

BANK COOPERATION ON FINANCIAL PROBLEMS

By E. B. Kixmiller

A FOOD-PRODUCT manufacturer in a western city had greatly increased his volume of business. He believed himself in good financial condition, and was looking forward to a good dividend. Yet when the profit and loss statement was laid before him at the end of the last quarter, he found he had not only made no progress, but had barely played even.

His investigation failed to uncover the leak. When he went to his banker to clean up, he talked the situation over with him. The banker offered to send an auditor to the factory to look over the business and make a report to him. The recommendations of the banker would be determined by the figures showing the manufacturer's condition.

The manufacturer had already explained that because of lack of capital, flour, the chief material used in the manufacture, was bought in small quantities intermittently. Flour fluctuated between $4.75 and $6.00 a barrel. If the manufacturer could buy his supply for the year somewhere near the bottom price, a big saving would result. The bank offered to keep the manufacturer advised of general conditions and—what was even more helpful—to extend accommodations at the most opportune time for purchasing. The saving here alone

was enough to start the factory on a substantial dividend paying basis.

The bank's representative also found that the concern was missing profits by not taking discounts, and that losses from bad credits were abnormal. The bank arranged to extend the manufacturer a sufficient line to enable him to discount his bills payable, taking as collateral such of the concern's bills receivable as were good, and to get credit information on customers whom the manufacturer considered doubtful or about whom he wanted facts that could not be obtained through ordinary sources.

The next year the factory declared a dividend and put away a surplus.

That is what one bank did for its customer—willingly and effectively. This manufacturer did not look upon his bank merely as a vault in which he deposited money, and to which he went to plead loans. He found the bank was ready to assume its responsibility as an advisory partner to its patrons.

INSTANCES *that show how business men have used banks to help solve business problems; securing the bank's cooperation in collecting past due accounts.*

The services the bank can offer are as varied as the different lines of business it serves. It can help almost everywhere; it can advise, safeguard, protect—help raise money, enlarge trade, decrease expense, and increase profits.

At one time, a lumber concern in the Northwest offered a shipper in a distant town its note for $2,000 at three months. The concern was one of the largest in its territory, supposed to be well rated and prosperous. One would unhesitatingly take such paper as a good risk.

But this shipper believed in keeping in touch with his bank. So before accepting the note he took the matter up with his banker. The banker advised deferring action and immediately wrote the correspondent bank in the large city where the lumber business was located. Its credit department started an investigation. It was found that the lumber company carried a substantial balance in its depositing bank and that ordinarily the bank would discount its bills receivable. Yet the bank accorded it no line of credit. And further investigation revealed that the trade generally gave the company no credit. Other confidential information of a derogatory nature was secured.

The country banker advised his customer to deal on a cash basis. The lumber concern failed the week following. The shipper, although he did not know the method of securing the credit information through the chain of financial institutions, realized forcibly that his policy of verifying his paper at his bank had saved him money.

The bank often makes a most effective collection agency. By virtue of his position, the banker is familiar with the business of every one in his locality and knows the most likely method of getting payment. Nearly every man will pay his bank in order to maintain his bank credit standing.

A chronic case of slow-pay in a small town was brought to terms in a short time by means of the pressure a bank brought to bear. The creditor had placed the account in the hands of collection agencies without any results. Finally he sued and won judgment. He was then no better off than before. His debtor was execution proof.

The matter was turned over to the local bank. The first request on the part of the cashier met with no more

success than the previous demands of the creditor. About a month later the debtor wanted to raise some cash. He came to the bank with a good note and asked to have it discounted. The cashier politely informed him that the previous bill would have to be paid before the bank would advance the money. The cash was a necessity, so the bill was paid.

HOW *a manufacturer used the bank to secure information on conditions, the acquirement of which required an organization extending over the entire country.*

Sometimes a concern wants a mass of detailed information the acquirement of which needs a big organization with country-wide ramifications. The bank is the best source—and willing to undertake the task. This involves the service, not of one bank, but of a group.

A structural iron house wanted to know the conditions of the building industry over the entire country. Exact knowledge was essential in signing its contracts which ran six months or more in advance.

One of the concern's depositing banks was made the medium for gathering the information. Inquiries were sent to its correspondents throughout the country; these in turn went to their sources of news. These exact facts, together with bankers' statements regarding general business conditions and prospects all came to the depositing bank. There the facts were classified and analyzed, and a detailed report made to the iron company.

The service for which the bank is most frequently called on is the raising of money. The ability of the bank itself to help a business man with its own funds is limited by its size, by law, by proper banking principles. But by its advice and service it can go far beyond this.

A medium-sized concern which had been running along

with good profits and moderate growth which it could finance out of its profits found its business expanding so fast that it needed more capital. The bank carrying its account was asked for advice. The banker explained that the corporation had open to it three methods of raising money; an increase in its capital stock; an issue of bonds—creating a funded debt; an issue of paper—creating a floating debt. The advice of the banker was the issue of more capital stock. That choice was based on the unbalanced statement the corporation showed at the time: the capital stock was too small for the volume of business done; the surplus was too large. Because the latter might have been drawn down by declaring it out in dividends so as to leave only a meager basis on which to carry the business, the firm, although perfectly solvent, was not regarded as a desirable risk. By issuing the stock along the lines suggested by the bank the corporation was able to raise the funds it needed, to secure a working cash capital, and to present a well-balanced statement.

Another business wanted five hundred thousand dollars to build a new foundry. The statement showed a proper proportion of capital stock and surplus. The owners did not desire to increase the capital stock because their profits were large and they believed they could pay for the new foundry out of their profits. The company could put aside at least $55,000 a year plus the interest on the required loan without cutting dividends.

But a loan of such large amount could not well be made by the bank; besides, if called on suddenly for repayment, the company, although solvent, might experience difficulties. A distribution of the firm's paper was open to the same objection, for such loans must be short-time, and liable to sudden contraction in case of tighten-

ing up of the money market. Under the circumstances a bond issue was the only method of securing the money, and of protecting the borrower from pressure at inopportune times. The earning power of the concern, backed by sufficient assets, made its bonds a sound investment. The banker was willing to help to the extent of underwriting them. The underwriting by the bank assured the security of the issue and evidenced the bank's willingness to loan a purchaser on the bonds. Under these circumstances no difficulty was met in selling the securities. The needs of the concern were satisfied.

A country bank was able to aid in the disposition of short-time paper for a firm requiring a larger loan than the law permitted a single institution to carry. Conditions did not require a bond issue. To the extent that the bank could loan, accommodations were accorded. The company was then referred to the bank's city correspondent broker with a recommendation from the bank. That stamp of approval is important for the negotiation of any paper. It is the evidence of the soundness of the borrowing concern that guides the banks purchasing the paper.

CONSULTATION *with the banker before buying saved one investor from a heavy loss by revealing a hidden disadvantage in an issue of investment bonds.*

A bond issue was floated on an office building in a western city, the income of which was four times the amount of the interest on the bonds. The building was on a leasehold of long term, the larger portion of which was yet to run. With all these elements the proposition looked most desirable. It sounded especially fine when termed a first mortgage lien on rental income, building and leasehold.

One investor sought the advice of his banker before buying. The result of a thorough investigation revealed a vital defect that would be likely to pass unnoticed by even the most careful investors. In the lease there was a rental revaluation clause calling for a readjustment of the land rent changes every ten years. The effect of the concealed joker was obvious; with a building situated on increasingly valuable land in a business district the lease-value is bound to rise if there is an opportunity for revaluation. The income will not rise in anything like the same proportion: in fact, the building is likely to become less productive as newer ones are erected. The leasehold itself is of no value save as it produces income. With the income liable to be swallowed up in an increasing ground rent, the assured profit becomes doubtful. The information secured from the bank cost the investor nothing; it saved him much.

When the southern Indiana coal fields were on the boom, a group of promoters secured options on a large portion of the farm land surrounding one of the more prosperous towns. The coal rights in the land were in most cases bought in as low as twenty-five dollars per acre. A few farmers went to their banks and asked for advice of the cashier. They were cautioned to hold off signing any contract until such time as they could canvass the situation and secure the best terms possible. Those wise enough to have consulted their banker obtained sixty-five dollars an acre.

More important even than the increase in the price secured for the coal right was the advice the banker was able to give in the drawing up of the provision of the contract concerning oil and gas royalties. The bank had a uniform instrument drawn up for all who were selling their mineral rights, and obtained for its patrons

the usual rates, while many others sold for a small royalty or none at all. This is another illustration of the innumerable ways in which the bank can prove of service to those who make use of its many sided activity.

The average business man, no matter how much he may know about his own business, is likely to be ignorant of the conditions prevailing in other lines. In matters of financial importance, and in questions involving knowledge of conditions foreign to his own business, the banker's advice is invaluable. The banker is at the center of the business and financial activities of his community. His advice in most cases marks out the course of safety, and his services may mean savings and increased profits.

ONE *of the most important causes of failure is the overdrawing of credit. Business men who draw against a credit which has not been securely established are unable to withstand a period of depression. Men who incur greater obligations in times of prosperity than their finances or prospects warrant, on the assumption that their business will grow sufficiently to enable them to meet the obligations at the time they become due, are successful only as long as that prosperity lasts. If an unexpected contraction in the money market occurs in the meantime, the strain upon their resources is greater than the business can stand and failure results.*

—Alexander J. Hemphill

Vice-President, The Guaranty Trust Company

XIX

HOW TO CHOOSE INVESTMENTS

By George Garr Henry
Formerly Vice-President, Guaranty Trust Company

WITH the immense increase and more general distribution of wealth in the United States, the problem of investment has assumed great importance. The number of business men in possession of funds in excess of their private wants and business requirements is very large; and richer men, to whom a surplus is not a new thing, have found their available funds steadily and quite often rapidly increasing.

The problem of investment thus forced upon the average business man is two-fold—it concerns the safeguarding of his private fortune and the wise disposition of his business surplus.

When the handling of a man's business surplus is spoken of as an investment problem, not his working capital, which should be kept in liquid form for immediate needs, is meant, of course, but that portion of his surplus which is set aside for emergencies. To create such a surplus is the established policy today of most of the well conducted and successful business enterprises in this country.

It is rightly felt that the possession of a reserve fund puts the business upon a secure foundation, adds to its financial strength and reputation, and greatly increases its credit and borrowing capacity. Moreover, this policy

is advantageous not only for large corporations like the express companies, who were among the earliest to adopt it, but it is equally advantageous for any business, no matter how small.

SURPLUS *funds are best disposed of by investment in securities—to keep them in bank deposits involves waste and tends to confusion with working capital.*

The recognition of this fact, combined with the ability to set aside a reserve fund, has brought many business men face to face with the problem of how to dispose of it. It is obviously a waste of income to have the surplus in bank accounts; more than that, there is a constant temptation to use it and to confuse it with working capital. It is best disposed of, plainly, where it is invested in some safe interest-bearing security, which can be readily sold and is thus available for use if necessity demands. To select such a security is no easy matter.

The average business man has found it easier to make money than to take care of it. Money making for him is the result of successful activity in his own line of business, with which he is thoroughly familiar, while the investment of money is a thing apart from his business, with which he is not familiar, and in which he may have had little practical experience. His failure to invest money wisely is not due to any want of intelligence or of proper care and foresight on his part, but simply because he is ignorant of the principles of a business which differs radically from his own.

If he attempts to rely on his own judgment, he is almost certain not to do the best thing, even if his business instinct leads him to avoid those enterprises which are plainly unpromising or fraudulent. It should be remembered in this connection that widows and orphans

are not the only ones ensnared by attractive advertisements and the promise of brilliant returns. In most cases, widows' and orphans' funds are protected by conscientious and conservative trustees, and it is the average business man who furnishes the money which is ultimately lost in all propositions which violate the fundamental laws of investment.

The average man is led into these unwise investments through a very natural error of judgment. Accustomed to take reasonable chances and to make large returns in his own business, he fails to detect anything fundamentally wrong in a proposition simply because it promises to pay well. He forgets that the rate of interest on invested money, or pure interest, is very small, and that anything above that can only come as payment for management, or at the sacrifice of some essential factor of safety which will usually lead to disaster.

The investment of money is a banker's business. When an investment is contemplated, therefore, the average business man should consult an investment banker, first assuring himself of the entire uprightness and reliability of his adviser, and then, after making a general statement as to the nature of his requirements, putting himself in his hands for the selection of a particular investment.

Before considering the general factors which determine the desirability of all investments, it will be well to present clearly the fundamental difference between promises to pay and equities.

Bonds, real estate mortgages and loans on collateral represent somebody's promise to pay a certain sum of money at a future date; and if the promise be good and the security ample, the holder of the promise will be paid the money at the time due.

On the other hand, equities, such as the capital stocks of banking, railway and industrial corporations, represent only a certain residuary share in the assets and profits of a working concern, after payment of its obligations and fixed charges. The value of this residuary share may be large or small, may increase or diminish, but in no case can the holder of such a share require any one, least of all the company itself, to redeem the certificate representing his interest at the price he paid for it, nor indeed at any price. If a man buys a $1,000 railroad bond, he knows that the railroad, if solvent, will pay him $1,000 in cash when the bond is due. But if he buys a share of railroad stock his only chance of getting his money back, if he should want it, is that someone else will want to buy his share for what he paid for it, or more. In one case he has bought a promise to pay, and in the other an equity.

This does not mean, however, that equities under no circumstances are to be regarded as investments. Many of our bank and railroad stocks, and even some of our public utility and industrial stocks have attained a stability and permanence of value and possess sufficiently long dividend records, to justify their consideration when investments are contemplated; but it is essential that the investor should have a thorough understanding of the distinction involved.

DESIRABILITY *of investments depends upon four general factors: safety of principal, interest rate, convertibility and possibilities of appreciation.*

There are four general factors which determine the desirability of all investments. These are (1) safety of principal and interest, or the degree of assurance of receiving the principal and interest on the dates due;

(2) rate of income, or the net return which the investment makes on the actual amount of money invested; (3) convertibility into cash, or the readiness with which it is possible to realize on the investment; and (4) prospect of appreciation in value.

Some may question the bearing of the last factor on the ground that appreciation in value is foreign to the idea of an investment, but the writer prefers to retain it, at least as applied to investments in the United States, believing that one is entitled, without losing his character as an investor, to share in the growth and development of a new country. The four qualities above enumerated are present in different degrees in every investment, and the scientific investor naturally selects those securities which possess in a high degree the qualities upon which he wishes to place emphasis. A large part of the problem of investment lies in the careful selection of securities to meet one's actual requirements. The average investor does not thoroughly understand this point. He does not realize that a high degree of one quality involves a lower degree of other qualities.

He may have a general impression that a high rate of income is apt to indicate less assurance of safety, but he rarely applies the same reasoning to other qualities. When he buys securities, he is likely to pay for qualities which he does not need. It is very common, for example, when he wishes to make a permanent investment and has no thought of re-selling, to find him purchasing securities which possess in a high degree the quality of convertibility. From his point of view, this is pure waste. A high degree of convertibility is always compensated for by the sacrifice of some other quality—usually rate of income. With more care in his selections he could probably find some other security possessing equal

safety of principal and interest and equal promise of appreciation in value, which would yield considerably greater revenue, lacking only ready convertibility. Thus he would satisfy his real requirements and obtain a greater income, at the expense only of a quality which he does not need.

Generally speaking, the private investor does not need to place much emphasis upon the quality of convertibility, at least for the larger part of his estate. On the other hand, for many purposes, ready convertibility is an absolute necessity, and in order to secure it, something in the way of income must usually be sacrificed.

Again, some investors are so situated that they can insist strongly upon promise of appreciation in value, while others cannot afford to. Rich men, whose incomes are in excess of their wants, can afford to forego large immediate returns for the sake of appreciation in value. Such men naturally buy bank and trust company stocks, whose general characteristic is a small return upon the money invested, but a strong likelihood of appreciation. This is owing to the general practice of well regulated banks to distribute only about half the earnings in dividends and to credit the rest to surplus, thus insuring a steady rise in the book value of the stock. Rich men, again, can afford to take chances with the quality of safety, for the sake of greater income, in a way which poor men should never do. In practice, however, it is usually the poor men who take the chances and lose their money.

In the quality of safety, there is a marked difference between safety of principal and safety of interest. With some investments the principal is much safer than the interest, and vice versa. This can best be illustrated by examples. The bonds of terminal companies, which are

guaranteed as to interest, under the terms of a lease by the railroads which use the terminal, are usually far safer as to interest than as to principal. While the lease lasts, the interest is probably perfectly secure, but when the lease expires and the bonds mature, the railroads may see fit to abandon the terminal and build one elsewhere, if the city has grown in another direction, and the terminal may cease to have any value except as real estate.

On the other hand, a new railroad, built in a thinly settled, but rapidly growing part of the country, may have difficulty in bad years in meeting its interest charges, and may even go into temporary default, but if the bonds are issued at a low rate per mile and the management of the road is honest and capable, the safety of the principal can scarcely be questioned.

SPECIALIZED *knowledge and experience are required for the selection of investments; in most cases the course of safety lies in securing the banker's advice.*

In another respect the services of a banker are indispensable. The quality defined above as safety of principal and interest, or the assurance of receiving the principal and interest on the dates due, should never be confused with the prospect of maintaining intact the principal sum invested. These are very different things, though frequently identified in people's minds. An investment may possess assured safety of principal and interest and yet suffer a violent decline in quoted price, owing to a change in general business and financial conditions. In times of continued business prosperity very high rates are demanded for the use of money, because the liquid capital of the country, to a large extent, has been converted into fixed forms, in the development of

new mines, the building of new factories and railroads and in the improvement and extension of existing properties. These high rates have the effect of reducing the price level of investment securities because people having such securities are apt to sell them in order to lend the money so released.

As an illustration of this tendency, New York City 3½ per cent bonds declined from 110 to 90, without the slightest suspicion of their safety. Their inherent qualities have changed in no respect except that their prospect of appreciation in quoted price has become decidedly brighter. Their fall in price was due to two factors, one general and the other special—first, the absorption of liquid capital and consequent rise in interest rates, occasioned by the unprecedented business activity of the country, and second, to the unfavorable technical position of the bonds, due to an increased supply in the face of a decreased demand.

If maintaining the quoted price is essential the best investment is a real estate mortgage, which is not quoted and consequently does not fluctuate. For the investment of a business surplus, however, where a high degree of convertibility is required, real estate mortgages will not answer, and the best way to guard against shrinkage is to purchase a short term security, whose approach to maturity will maintain the price close to par.

A CREDITOR *knows that you ask for credit because you need it. He doesn't expect your business statement to show a great cash surplus; if you had one, you would discount his bills. All he asks is to know how you stand—just what chance he and you together are taking.*

—Henry Clews
Founder, Henry Clews & Company

XX

JUDGING THE MONEY MARKET

By George Garr Henry
Formerly Vice-President, Guaranty Trust Company

NO question connected with the investment of money is more important than the ability to judge whether general market conditions are favorable for the purchase of securities.

After learning how to judge the value of every form of investment, a man may still be unsuccessful in the investment of money unless he acquires also a firm grasp upon the general principles which control the price movements of securities. This does not mean that a man needs to have an intimate knowledge of technical market conditions whereby to estimate temporary fluctuations of minor importance, but rather that he should have clearly in mind the causes which operate to produce the larger swings of prices.

If an investor acquires such a knowledge he is enabled to take advantage of large price movements in such a way as to materially increase his income, and, at the same time, avoid carrying upon his books securities which may have cost much more than their current market quotations. If he can recognize the indications which point to the beginning of a pronounced upward swing in securities, and if he can equally recognize the signs which indicate that the movement has culminated, he can liquidate the securities which he bought at the inception

of the rise, or transfer them to some short term issues whose near approach to maturity will render them stable in price, allowing the downward swing to proceed without disturbing him.

INFLUENCES *that control the market movements of negotiable securities; how the prices of securities are affected by the prevailing interest rates.*

Broadly speaking, the market movements of all negotiable securities are controlled by two influences, sometimes acting in opposition to each other and sometimes in concert. One of these influences is the loaning rate of free capital; the other is the general condition of business. A low rate of interest or the likelihood of low rates has the effect of stimulating security prices, because banks and other money-lending institutions are forced into the investment market when they cannot loan money to advantage. Conversely, a high rate of interest or the prospect of high rates has the effect of depressing prices, because banking institutions sell their securities in order to lend the money so released.

The automatic working of this process tends to produce a constant adjustment between the yields upon free and invested capital. When money rates are low, securities tend to advance to the point where the return upon them is no greater than that derived from the loaning of free capital. When rates are high, securities tend to decline to a point where the return is as great. This explains the influence of the first factor.

The other factor is the general condition of business. Good business conditions or the promise of good conditions tend to advance security prices, because they indicate larger earnings and a stronger financial condition. Poor business conditions or an unpromising outlook have

the reverse effect for equally obvious reasons.

The larger movements of security prices are always the resultant of the inter-action of these two forces. When they work together the effect is irresistible, as when low interest rates and the prospect of good business conditions occur together, or when high money rates occur in the face of an indicated falling off in business activity. At such times all classes of securities swing together. For the most part, however, money rates and business conditions are opposed in their influence, rates being low when business is bad and high when business is good.

Usually, the worse conditions become, the easier money grows; while the more active business becomes, the higher money rates rise. The effect of this antagonism between the controlling causes is to produce movements of different proportions and sometimes in different directions in different classes of securities. High-grade bonds may be declining, middle-grade bonds remaining stationary and poor bonds advancing, all at the same time.

This serves to give a very irregular appearance to the security markets, and appears to justify the widely held opinion that security prices are a pure matter of guess-work, and that they are controlled only by manipulation and special influences. A clear conception of the nature of the influences which are always silently at work, reconciles these apparent inconsistencies and makes it plain that general price movements are determined by laws as certain in their operation as the laws of nature.

This may be illustrated by a single example. Let us assume that interest rates are low and business conditions bad with prospect of still lower interest rates and still more unpromising business conditions. What will be the effect upon different classes of securities?

High-grade bonds, such as choice municipals, whose safety cannot be impaired by any extent of depression in business, will advance because their market price is influenced almost wholly by money rates. If their interest is certain to be paid, no matter what business conditions may become, they cannot be greatly affected by a reduction of earnings, and consequently the influence of low money rates is left to act practically alone. Middle-grade bonds will remain almost stationary, low money rates tending to advance their price and the fear of decreased earnings tending to depress them. The lowest grade of bonds and stocks, whose margin of security even in good times is not very great, will probably suffer in price because the fear of default in interest and of reduction in dividends will operate much more strongly than the mere stimulus of low interest rates.

Of course, securities cannot be clearly separated into these three classes, but shade imperceptibly into one another. The classification is adopted only for purpose of illustration.

INDICATIONS *based upon close observations of past financial movements enable investors to forecast the direction of general swings in the market prices.*

Up to this point we have been concerned merely in showing that the market movements of negotiable securities are controlled by the influence of certain factors. A more important question now remains to be considered: whether the effect of these two influences is to produce general swings in prices which may be depended upon with comparative certainty, and, if so, what indications are afforded to the investor of the commencement or culmination of such a movement. The answer must be that the combined effect of the two influences described is to

produce definite and regular swings in prices, and that the indications which define the movements are not difficult to follow.

A general survey of the history of every industrial nation reveals the fact that the business conditions undergo alternate periods of prosperity and depression extending in clearly defined cycles of substantially uniform length. By tracing the usual course of interest rates and of business conditions throughout one of these cycles, a general idea can be formed of the way in which the joint influences operate to produce price movements.

Immediately after a financial crisis, which usually closes an era of business prosperity, money rates become abnormally easy. Soon after the climax of the crisis, money accumulates in enormous volume in financial centers. This is caused by the great diminution of business activity which renders unnecessary a large part of the circulating medium which was required to transact the greater volume of business which formerly prevailed. To the extent to which this accumulation of money merely reflects a redundancy of currency as distinguished from real liquid capital it can have little effect in encouraging the resumption of business activity. As time passes, however, and economies in operation commence to make themselves manifest, and especially as waste and extravagance are curtailed, the country as a whole commences to accumulate real liquid capital; that is to say, its total production leaves a surplus over the amount of consumption.

In the state of business feeling which has been pictured, the undertaking of new business ventures or additions to existing properties would not be approved, so that the surplus wealth created finds its way into bank deposits as liquid capital. The competitive attempt

H. P. DAVISON

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PART I—ORGANIZING CREDIT WORK

The Path to Power

THE only genuine power which an individual, or a group of individuals, can gain is that arising from the confidence reposed in him or them by the community.

Every town, large or small, seems to choose a limited number of men (merchants, manufacturers, lawyers and bankers) to represent it in the management of its chief local industries. Those men are entrusted with such heavy responsibilities because of the confidence which their records have established, and only so long as their records are unblemished do they retain such trusts.

These are axioms which it seems almost idle to repeat. They apply to all business, but more emphatically, I believe, to banking than to any other form of commerce.

To banking the confidence of the community is the breath from which it draws its life. The past is full of examples where the slightest suspicion as to the conservatism or the methods of a bank's management has destroyed confidence and drawn away its deposits over night. Much, therefore, may be left to the instinct and the force of public opinion.

to loan this capital at the time when borrowers are few produces merely nominal interest rates. This continues for some time. It is only gradually as confidence returns and as the spirit of initiative begins to reassert itself, that some part of the liquid capital created each year is diverted into fixed forms. Here and there some enterprising group of men will develop a mine, lay a new piece of railway or make some addition to an existing undertaking. For some length of time, however, the liquid capital of the country not only remains unimpaired, but is continually increasing. After a time a change comes. The annual surplus of production, though larger than before, is only sufficient to provide for the new undertakings which the growing optimism demands. Interest rates rise moderately in response to the added demand for capital.

GENERAL *conditions that follow the culmination of a financial crisis; the immediate effects on business conditions, capital and rates of interest.*

A few years further along, as business activity increases and success appears plainly to wait upon new ventures, the demand for new capital with which to develop increased facilities and new enterprises exceeds the annual supply of wealth created. The spirit of economy and thrift which had prevailed throughout the years of depression gives place to extravagance, the demand for luxuries, and other unproductive forms of expenditure. While the total production is much greater than in the lean years, the margin of production is not proportionately as great, and this amount is insufficient to meet the demands upon it. The supplies of liquid capital stored up during the years of depression are resorted to and they serve to provide the new capital for a

few additional years. Interest rates at once reflect the encroachment upon stored up capital and their rise gives the first real warning of the country's true position.

The optimistic business men do not heed the warning. After exhausting all the real capital available in the country, they proceed to borrow extensively from foreigners. Every step which can be taken to induce foreigners to part with their capital is resorted to. If they will not buy long term bonds, short term notes are created. If they refuse these, they are asked to make loans secured by the new bonds and notes.

Finally the day of reckoning arrives, when some incident, usually unimportant in itself, first suggests to the lenders of money that their debtors whom they know to be over-extended may not be able to pay their loans. The attempt to collect their loans produces a financial crisis which brings to an end the period of prosperity.

The foregoing is a description of the more important stages through which business conditions pass from crisis to crisis. Different cycles vary in particular details, but all agree in essential outlines. Sometimes special influences are at work which operate to shorten or prolong the cycle. The approach of a crisis will be retarded by inflation of currency, for the excess finds its way into bank vaults and increases the volume of loanable credit.

The effect of such inflation, however, is wholly disastrous, because the addition to the supply of capital is fictitious, not real, and only defers the day of reckoning for a greater catastrophe. On the other hand the approach of a crisis can be greatly hastened by wars, conflagrations, and other agencies which destroy capital, and by attacks upon capital and conduct of corporate business, for such attacks tend to render capital timid and produce the same effect as a violent curtailment of

the supply. These are only some of the many influences which might become operative, but they serve to show the necessity for careful consideration of all the factors at work, if a true conception of the conditions and tendencies of business is to be formed.

Business conditions remain poor or grow worse for a few years after a crisis. Liquidation is taking place, prices are going down and the uncertainty of the outlook causes diminished activity. Thereafter, however, conditions improve and activity increases with fair uniformity until it reaches the high tension of the period immediately preceding the crisis. The course of interest rates and the course of business conditions may both be deflected by the operation of special influences, but the general tendencies are substantially as outlined. The result of the operation of these joint factors may be traced in the market movements of any class of security desired.

For the sake of simplicity, let us consider the effect of the market swings on the highest grade of investment issues and on the lowest grade, those which are affected only by money rates and those which are affected almost wholly by business conditions.

Emerging from the strain of the crisis at their lowest point, high-grade bonds, such as the best municipal and railroad issues, advance rapidly as interest rates decline, continuing their advancing tendency throughout the period of business depression which follows upon the heels of the crisis. As business conditions improve, their position, while perfectly secure before, is further strengthened and an added stimulus is given to their rise. About the middle of the cycle when the business outlook is very promising, and before interest rates have sustained any material advance the prices of the best bonds are usually at their highest point. From that

time forward they commence to decline, in spite of the increasing prosperity of the country, under the influence of rising money rates. They make their lowest prices in the midst of the crisis, when the strain upon capital is greatest.

The lowest grade of bonds, on the other hand (whose margin of security is least), do not commence to recover materially in price, in spite of the influence of low money rates during the hard times which follow the crisis, the influence of reduced earnings and the fear of default holding them in check. As the outlook becomes brighter they advance rapidly and continue to improve in price so long as they yield more than current money rates. At some point difficult to determine in advance but usually well along toward the end of the cycle they reach their high point and thereafter decline under the influence of the growing stringency in money.

Between these two extremes, every class of security is to be found. The better ones will tend to resemble, in their market movements, the course pursued by the choicest bonds; the poor ones will approximate the lowest class. In every case, however, unless special influences operate to produce variations, the market swing of a given security should be easily conjectured by an investor who gives careful attention to the relative weight which is likely to attach to each determining influence.

THE *true credit of commerce is that built only through fair representation. This is the credit that stimulates industry, inspires confidence, and creates a healthy activity.*

—Henry Clews
Founder, Henry Clews & Company